24 II

VOLUME AND STABILITY OF PRIVATE INVESTMENT

HEARINGS

BEFORE THE

JOINT COMMITTEE ON THE ECONOMIC REPORT
CONGRESS OF THE UNITED STATES

EIGHTY-FIRST CONGRESS

FIRST SESSION

PURSUANT TO

SEC. 5 (A) OF PUBLIC LAW 304
79TH CONGRESS

PART 2

DECEMBER 6, 7, 8, 9, 12, 13, 14, 15, AND 16, 1949

Printed for the use of the Joint Committee on the Economic Report

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CONTENTS

Statement of— Page

Bryan, Joseph M., first vice president, Jefferson Standard Life Insurance Co — 273
Clarke, Dwight L., president, Occidental Life Insurance Co. of California — 241
Dumont, Allen B., Allen B. Dumont Laboratories — 425
Ecker, Frederick W., financial vice president, Metropolitan Life Insurance Co — 156
Fackler, Clarence W., research committee, Investors League, Inc — 615
Ford, Horace S., treasurer and member of the executive committee, American Research & Development Corp — 472
Green, William, president, American Federation of Labor — 621
Griswold, Merrill, chairman of the board of trustees, Massachusetts Investors Trust — 446
Hackett, W. T., vice president, Huntington National Bank (Columbus, Ohio) — 496
Hagerty, Harry C., vice president and treasurer, Metropolitan Life Insurance Co — 156
Hopkinson, Edward, Jr., Drexel & Co — 655
Devereux, Joseph C., president, New York Life Insurance Co — 300
Kassalow, Everett M., executive secretary, CIO Full Employment Committee — 591
LaForce, Arnold, assistant vice president, Metropolitan Life Insurance Co — 156
Lincoln, Leroy A., president, Metropolitan Life Insurance Co — 156
Patrick, Robert B., financial vice president, Bankers' Life Co — 390
Reed, Philip D., chairman of the board, General Electric Co — 527
Pope, Allan M., president, Investors League, Inc — 613
Ruttenberg, Stanley, director, Department of Educational Research, CIO — 590
Sholley, Sidney L., president, Keystone Custodian Funds, Inc — 575
Smith, Winthrop H., Merrill Lynch, Pierce, Fenner & Beane — 671
Stires, Hardwick, representing the National Association of Investment Companies — 560
Sykes, R. V., administrative assistant, Mutual Life Insurance Co. of New York — 355
Van Alstyne, David, Jr., Van Alstyne, Noel & Co — 625
Whipple, Oliver M., financial vice president, Mutual Life Insurance Co. of New York — 355
Whitney, J. H. & Co — 488
Woodward, Donald B., second vice president, Mutual Life Insurance Co. of New York — 189

Round-table discussions:

Small Business Advisory Committee, Department of Commerce — 115

Participants:

Aitken, John, certified public accountant (Philadelphia).
Bimson, Walter R., banker, Phoenix, Ariz.
Ford, William S., consulting engineering, Milwaukee, Wis.
Hughitt, C. F., Chief, Small Business Division, Department of Commerce.
Kaletzki, Charles M., public relations and advertising, Syracuse, N. Y.
Kelly, James L., Assistant Director of the Office of Domestic Commerce, Department of Commerce.
Lane, Larry, publisher, San Francisco, Calif.

Page

Round-table discussions—Continued
Small Business Advisory Committee, Department of Commerce—Con.
Participants—Continued
Mace, Myles L., vice chairman, Harvard Business School.
Miller, Harry L., chairman, Small Business Advisory Committee.
Milton, Lorimer D., banker, Atlanta, Ga.
Ragland, Charles S., wholesale grocer, Nashville, Tenn.
Stevenson, Russell A., dean, School of Business Administration, University of Michigan.
Stewart, Ross, wholesale automotive equipment, Houston, Tex.
Weaver, Robert, manufacturer, Waltham, Mass.
White, Lysander, management consultant, New York, N. Y.
Financing small and intermediate business 683
Participants:
Dockeray, J. C., Department of Commerce.
Hopkinson, Edward Jr., partner, Drexel & Co., Philadelphia, Pa.
Kaplan, Dr. A. D. H., the Brookings Institution.
Kelly, James L., Assistant Director of the Office of Domestic Commerce, Department of Commerce.
Koch, Albert R., Division of Research, Federal Reserve Bank.
Madden, James L., second vice president, Metropolitan Life Insurance Co.
Smith, Winthrop H., partner, Merrill Lynch, Pierce, Fenner & Beane.
Whipple, Oliver M., financial vice president, Mutual Life Insurance Co.
Other material:
Letters of Joseph C. O'Mahoney, chairman of the subcommittee, to Messrs. Leroy Lincoln, Oliver M. Whipple, and Harry L. Miller 494
Letter of Leroy A. Lincoln to Joseph C. O'Mahoney, chairman of the subcommittee 495
Laws governing life-insurance company investments, summary of, selected States 466
Number of business firms in operation, September 30, 1943, and 1948, appendix A 711
Reconstruction Finance Corporation supplemental data, appendix B 712
Topics and questions which witnesses were asked to consider, appendix C 715
Report: "Unsuccessful Postwar Security Financing," Charles H. Schmidt, Division of Research and Statistics, Board of Governors, Federal Reserve System 649

VOLUME AND STABILITY OF PRIVATE INVESTMENT

TUESDAY, DECEMBER 6, 1949

CONGRESS OF THE UNITED STATES,
JOINT COMMITTEE ON THE ECONOMIC REPORT,
SUBCOMMITTEE ON INVESTMENT,
Washington, D. C.

The subcommittee met, pursuant to call, at 2:05 p. m., in the caucus room, Senate Office Building, Senator Joseph C. O'Mahoney (chairman) presiding.

Present: Senator O'Mahoney (chairman) and Representatives Herter and Buchanan.

Also present: Dr. Grover W. Ensley, acting staff director; David Scoll, special counsel to the committee; James L. Kelly, Assistant Director of the Office of Domestic Commerce, Department of Commerce; C. F. Hughitt, Chief, Small Business Division, United States Department of Commerce; Harry L. Miller, chairman, John Aitken, Walter R. Bimson, William S. Ford, Charles M. Kaletzki, Larry Lane, Myles L. Mace, Lorimer D. Milton, Charles S. Ragland, Russell A. Stevenson, Ross Stewart, Robert Weaver, Lysander T. White, members of the Small Business Advisory Committee, Department of Commerce.

The CHAIRMAN. The hearing will come to order.

I think it is rather fortunate that we have so many members of the Small Business Advisory Committee of the Department of Commerce here today to discuss with us formally and in open session the nature of the hearings on investment which will begin tomorrow.

Mr. Kelly of the Department of Commerce is present. Mr. Kelly, I think it will be helpful for all concerned if you would introduce each of the members of the advisory committee who are present, and I would be very glad to have you announce any special order of presentation that the members would like to follow.

Mr. KELLY. Thank you, Senator.

The CHAIRMAN. Give your full name, please, Mr. Kelly.

Mr. KELLY. James L. Kelly, Assistant Director of the Office of Domestic Commerce, Department of Commerce.

I am here, Senator, more or less as a shepherd of this group this afternoon because they are appearing before your committee as an independent group.

The CHAIRMAN. I want to show them all that nobody is going to cut any wool in this outfit.

Mr. KELLY. I would like to present various members, starting with the chairman of the Small Business Advisory Committee, Mr. Harry Miller, manufacturer, from Chester, Pa.

The vice chairman of the committee, Prof. Myles Mace, of Harvard Business School.

Mr. John Aitken, certified public accountant, of Philadelphia.

Mr. Walter Bimson, banker, from Phoenix, Ariz.

Mr. William Ford, consulting engineer, from Milwaukee, Wis.

Mr. Charles M. Kaletzki, public relations and advertising, from Syracuse, N. Y.

Mr. Larry Lane, publisher, from San Francisco.

Mr. Lorimer Milton, banker, from Atlanta, Ga.

Mr. Charles Ragland, wholesale grocer, from Nashville, Tenn.

Dean Stevenson of the School of Business Administration, University of Michigan.

Mr. Ross Stewart, wholesale automotive equipment, of Houston, Tex.

Mr. Robert Weaver, manufacturer of Waltham, Mass.

Mr. Lysander White, management consultant of New York City.

Senator, Mr. Harry Miller will speak for and on behalf of the committee.

The CHAIRMAN. It is my understanding, Mr. Miller, that several members of the group have come prepared to make presentations.

Mr. MILLER. That is correct.

The CHAIRMAN. Would you give me the names of those persons who expect to make presentations?

Mr. MILLER. Mr. Stewart, Mr. Bimson, Mr. Aitken.

The CHAIRMAN. And yourself?

Mr. MILLER. And myself.

The CHAIRMAN. You are to open this?

Mr. MILLER. That is correct.

The CHAIRMAN. Let me say that, for a long time, Members of Congress have been aware of the many difficulties that small business throughout the country is obliged to contend with. It has been recognized for a long time that Government policy should be directed, so far as possible, to the encouragement and stimulation of the growth of small business.

As long ago as March 1941, when I had the privilege of filing the report of the Temporary National Economic Committee, it contained several recommendations with respect to the encouragement of small business, particularly one dealing with the desirability of incentive taxation. We pointed out in that report that unless small business has the opportunity to start and to thrive it will be difficult indeed for business itself as a whole to grow.

We consequently welcome this opportunity of discussing the problems of small business and of investment with your group.

It is my understanding that you would like to present your prepared statement and then later submit to any questions that members of the committee or of the staff might desire to propound. Is that correct?

Mr. MILLER. That is correct, Senator.

The CHAIRMAN. Would you prefer to have all four presentations first?

Mr. MILLER. We would prefer that.

The CHAIRMAN. After that has been done, we will resolve ourselves into a round table to discuss the points which have been made.

Mr. MILLER. I am sure that will work out very well with our committee.

The CHAIRMAN. Very good, Mr. Miller, the committee is ready to hear you.

Mr. MILLER. I am Harry L. Miller, president of the Chester Dairy Supply Co., of Chester, Pa., and chairman of the Small Business Advisory Committee to the Secretary of Commerce. The Small Business Advisory Committee is made up of 24 small-business men whose businesses are located in practically all parts of the country. Many types of businesses are represented together with three educators from important business schools who are primarily interested in the development and guidance of small business. The committee members are appointed by the Secretary of Commerce and, of course, serve without pay and at their own expense. As a general rule, two 3-day meetings are held each year in Washington. It is our purpose to discuss the problems of small business having to do with management, taxes, various types of legislation, procurement, and any matters that either the Secretary of Commerce may ask us to consider or that any member of the committee may suggest. The general committee is divided into various subcommittees which undertake studies of these various problems and, at the end of each of our meetings, we present to the Secretary our recommendations setting forth the committee's ideas as to how these problems may be solved.

We appreciate very much being asked to appear here and to have the opportunity to present to you our ideas with regard to your particular investigation. Our committee is inclined to express themselves without restraint. It should be understood that our statements and recommendations that will be made here are the statements and recommendations of the committee and have been approved by it, but have in no sense received the approval of the Secretary of Commerce. At our final meeting tomorrow, however, we will present these same recommendations, together with other recommendations having to do with other problems, to the Secretary.

I am sure it will be interesting for you to know that this committee has been in existence since 1945, and that over the years the members of the committee have shown sufficient interest in its work so that on the average the meetings are attended by approximately 80 percent of the full panel. I regret to state that not all, by any means, of the recommendations that we have made to the various Secretaries have been fully accepted.

It is our purpose today to discuss the problems of taxation and depreciation and other matters that affect the financial problems of the small-business man. Following these discussions, we are submitting to you a definite recommendation that we believe could be used successfully in solving most of the financial problems of small business.

We do not believe that small business is entitled to or should receive subsidies from the Federal Government or elsewhere. We do not believe that all small business should be given financial assistance to the detriment of the common good. We simply believe that small business is very important to American free enterprise and American life, and that every effort should be made to enable small business to succeed in such a way that small business will be proud of itself and have its share in the development of our country.

Small-business men, I presume, at least it is so in my case, have little opportunity to meet with congressional committees and are not fully experienced in the ways of such committee work. We would request, therefore, if it meets with your approval, the opportunity to make the statements we have prepared without interruption, after which the entire committee would be very pleased to answer any questions that may be put before it, if they are able to do so. I am very sorry the chairman of our subcommittee on legislation, which covers the problems of taxation, equity capital, and so forth, in our deliberations, is ill and could not attend today's meeting.

As is unquestionably already known, the really big problem of small business is the problem of taxation. It is very difficult under present tax laws for small business to create and retain its own working capital.

The committee has asked Mr. Walter Bimson, of Phoenix, Ariz., to prepare a statement dealing with taxation and the problems brought about by taxation as related to small business. I am pleased to present Mr. Bimson, a member of the legislative subcommittee, to you at this time.

The CHAIRMAN. Mr. Bimson.

Mr. BIMSON. This committee of Congress recognizes, I am sure, that it is undertaking an extremely important, but also a very difficult task in attempting to determine the causes for the apparent reluctance of the American investor to buy the common stocks of business and industry.

This present apathy to risk personal savings in business enterprises appears to be a strange and unusual phenomenon in our American economy. Certainly, the willingness to risk his savings in new ventures has been, in the past, a typically American tradition. This willingness to venture, to take risks, has often been characterized in the past as the basis for our rapid progress, our extraordinary development, our high standard of living. We have grown up on the pleasing assumption that every American has the right and really enjoys the privilege of risking his all in any business venture he pleases. He may lose his shirt or make a million, but if he loses he always has the privilege of starting over again. We have had a certain amount of pride in this reckless exuberance of the American investor even while we were finding it necessary to set up certain restrictions upon his exuberance as a safeguard to our economy.

This present apathy of the investor is stranger still when we realize that the savings of our people during and following the war have been accumulating at an unprecedented rate. Certainly there is no lack of capital for investment. Likewise, there is no lack of opportunity to invest for stock prices in relation to earnings and rates of return have been low.

There have been encouraging signs, however, if one studies the Department of Commerce figures on the establishment of new, small businesses during the postwar years.

In 1944, 354,800 new businesses were established; in 1945, 429,800 new businesses were established; in 1946, 619,200 new businesses were established; in 1947, 473,800 new businesses were established; in 1948, 394,700 new businesses were established.

Certainly this is evidence that there is still life and courage in the patient, and that he is willing to risk his personal savings in his own business ventures, even if he is reluctant to exchange his savings account or his war bond for a stock certificate in a big corporation.

At any rate, it is not the belief of the Small Business Advisory Committee that there is anything wrong with the patient that a little reasonable care and encouraging treatment will not cure.

Our committee, in the consideration of problems affecting small business, has repeatedly pointed out in our recommendations to the Secretary that there are certain factors that now operate as a definite handicap to small business and we have from time to time suggested corrections to these conditions.

One of the most important discouraging factors affecting small business, we believe, is the rate and method of taxation that has been devised by Congress to finance the heavy expenditures of the Government.

We are quite aware of the necessity of recovering from income and other sources of taxes, sufficient money to meet currently the cost of Government. But we believe in some instances the rate and method of levying the tax acts as a definite deterrent to business and in the long run does more harm than good.

Specifically, we believe the double taxation of corporation dividends should be eliminated so as to give the investor a more adequate return on his money. Certainly there is little fairness in taxing both the corporation and the individual investor on the same income. This change alone would do much to bring savings into the equity market, we believe. The loss of revenue to the Government would be small (in 1947 dividend payments amounted to only 3.6 percent of total personal income) and the stimulation this would give to investors and to business as a whole would be beneficial to the whole economy.

Let me illustrate what happens to the stockholder by telling you about my own business. Last year we earned $4.36 a share. We paid $2 a share in taxes. Since we are short of working capital we paid dividends of 60 cents a share and retained $1.76 in the business. Now our stockholders paid a personal tax on their dividends ranging from about 25 percent to 75 percent. If we assume an average of 50 percent, the stockholder paid 30 cents a share.

So far as the stockholder was concerned, his business and he personally paid $2.30 in taxes in order to get 30 cents to spend or reinvest outside of the business. At current market prices for the stock, he got a net dividend return after taxes of 2 percent. Is it any wonder that our stock is selling at a price that represents about 50 percent of the liquidating value of the business?

We need a revision of tax laws relating to small business and newly established businesses, so that they may retain the first portion of their earnings without tax or at a reduced rate, or upon a graduated scale so that the small business and newly established business will have a chance to accumulate sufficient capital out of earnings to grow and prosper. If it does grow and prosper, it will and can pay a bigger rate of tax and return more money to the Government than it will limping along under a capital deficiency that retards its growth and expansion.

We need a clarification of Treasury Department interpretation of section 102, which actually threatens only small business, so that small business may be freed from the fear of reprisals for attempting to accumulate working capital.

Also, small business needs more flexibility in the Treasury Department's application of rates of depreciation of equipment and tools.

And finally, small business needs some additional facilities for obtaining short- and long-term credit.

These last two proposals will be discussed in separate presentations.

In conclusion, let me assert our belief in the resourcefulness and ingenuity and courage of the American businessman. Given a reasonably favorable set of conditions to work under and a reasonable chance to receive a fair reward for his efforts, he will continue to play his part in creating a stable and prosperous country.

Thank you.

The CHAIRMAN. Thank you very much, sir.

Mr. MILLER. We have discussed in our general committee work constantly the problem of depreciation as it affects the net income that the small-business man is able to get, which, of course, re-emphasizes itself in the small-business man's problem of getting capital.

We have spent a great deal of time in discussion of that over the years, and Mr. Ross Stewart is going to present a paper on that, as Ross has given a great deal of study to that particular subject.

The CHAIRMAN. Mr. Stewart.

Mr. STEWART. This will be partly statement and partly a discussion.

No program is worthy of serious consideration unless it benefits first the public at large, and second our Government. And this applies to accelerated depreciation.

The one principle that makes our country different from other countries is our high degree of production per man-hour. This is brought about primarily by the very best of equipment and facilities. Therefore, anything that will increase the productivity of our industries and plants will keep our standard of living high. The benefits to the Government would be through a better-equipped Nation that would produce more of everything in case of an emergency; and, second, the greater the production, the greater the tax revenue for the operation of our Government.

In my opinion accelerated depreciation will contribute more to increased production than anything else in face of the present tax problems. Accelerated depreciation will make it possible for industry to continue building up its productive capacity. This would take care of:

First, added revenue through tax channels.

We think that if industry was allowed to build up its production, you would have a broader tax base to collect taxes from through the increased production of the products that the equipment would produce and the plants would produce. You would get the taxes from the added production, the distribution and the servicing of the equipment, and it would bring about a greater tax revenue than any other thing you could have by the increasing of production by improving plant facilities.

It would enable small business to grow and would not hurt large business. It is much more important, as we see it, to small business to have some flexibility and be able to set up their own schedule of depreciation on equipment they may select to buy for plant improvement, equipment—probably store improvements—or any other type of capital improvement.

A large business has a capital structure whereby they can depreciate and charge off and handle these improvements and matters of depreciation more or less to suit themselves, whereas small business has not the leeway, and is pretty well confined by the regulations that have been established through the Internal Revenue Bureau. It makes it very difficult for a small business, particularly if it is confronted with the possibilities of developing a new product, or handling a large contract where it requires capital equipment to do it. It may be a successful venture in every sense of the word from the standpoint of the contract, but it would prove to be disastrous if the profits would have to be taxed and the equipment set up on the books and amortized over a period of 10 to 20 years.

There has been many a small industry which has found itself in much worse shape after receiving and doing a successful contract for that very reason than if it had passed it up. There have been some businesses, small businesses, that have gone on and taken them and found themselves in very bad shape and have had to liquidate.

Therefore, I say that it is important to small business to have that liberalization of depreciation which can be charged off during the period of the particular immediate work at hand or the immediate program at hand.

This would increase employment.

Now that sounds rather interesting, but I can see how it could. We have never had any difficulty in employment when heavy industries were engaged, and busily engaged. Competition gets a little bit more keen. The only place for industry or the business people to turn is to more efficiency in order to be more competitive, which means better plants and better facilities and more development of various kinds in order that they can be more competitive. That automatically builds up the building trade, the heavy-industry business, and machinery business; and I think, when those businesses are all going along in good healthy condition, that contributes a good deal to taking care of any unemployment problems that may come up.

It would work against inflationary tendencies.

I do not think there is anyone who doubts that the best way to cure any inflation, and the most practical way, in a stable money market, if it is stable at all, is to have the producer bidding for the dollars. That is competition and the type of competition which eliminates inflation.

I do not think there is any doubt that whenever you do not have a short supply of products but you have a full supply there is bidding for the dollar. You then get lots of smart competition and lots of progress, and at the same time you do not get inflation. And that is one thing that it seems some people are rather concerned about, the possibilities of some further inflation which may be in the future. I think that probably one of the best ways to combat it would be increased production. And this (accelerated depreciation) is probably one logical way to accomplish that—through better facilities and better plant equipment.

It would enable small business to finance itself much easier.

That, of course, is one of the problems of small business and one of the most serious problems. If a small business was successful in getting a contract, or if it were running a prosperous little business, and it wanted to make some capital type of improvements and could show the banker that these improvements would contribute to profits over a period of a reasonable length of time adequate to take care of the cost of these improvements in a manner acceptable to the Bureau of Internal Revenue agents, it would be rather simple to finance them. I think it would make a great contribution to simplifying the matter of financing improvements of the capital type if businessmen were allowed to set up their own schedule of depreciation.

It would build up our production so we could compete in international markets without tariff. At least it would contribute toward that which, I think, all businesses are hoping to be able ultimately to do.

As I understand it, the ideal thing is for us to build up our production and be able to trade in these foreign markets and in exchange take raw materials that are in short supply in this country. That can be done if we can build up the efficiency of our production. By encouraging industry to improve their plant facilities, and doing it, it is highly possible it can be done.

We give you an example of the automobile industry. As I understand it, there are no high tariff walls around the automobile industry. We can build automobiles in this country, as I understand it, cheaper than comparable cars can be built in other countries with much lower material prices and lower cost labor. And that is a fruit of what is probably one of the best-organized and best-equipped mechanical set-ups in this country. They have kept themselves up to date and they have set a fine example, I think, for other industries to follow.

In conclusion, nothing but good could come from accelerated depreciation, as there is no posibility of a single individual or a group of individuals benefiting beyond a reasonable amount, as individual income tax and inheritance tax adequately take care of any possibility of this suggestion bringing about a concentration of wealth.

It is true accelerated depreciation will cause both small and large business to grow. All businesses are producers of wealth which represent a higher standard of living and a strong Nation. Accelerated depreciation will encourage production development at no ultimate cost to the Government inasmuch as the Government and the public will ultimately collect the fruits from this added production—first, by the normal taxes, and second, through the inheritance tax. The only way to beat this would be to give the property away to good foundations. And with enough of these well-managed foundations the Government's social problems might perhaps be minimized.

I might conclude by saying: Allowing these businesses to handle their own depreciation, as I see it, is no different than allowing the businessmen to invest their money in greater production for the betterment of the general condition of this country. They will make a great contribution, and will continue to contribute—I am talking about the small ones in particular—if they are given just a fighting chance to grow and to build. Therefore, we think it is one of the major problems in the welfare of the country as well as the welfare of small business.

Thank you.

The CHAIRMAN. Thank you, Mr. Stewart.

Mr. MILLER. We, as you will see, feel that the impact of taxation and the problems of depreciation are the two main factors that govern the flow of capital particularly into small businesses because it is too risky. So we are trying our best to impress you with those two points.

Mr. Aitken, of Philadelphia, who is a public accountant, has approached this problem from the standpoint of an accountant, and we would like to have Mr. Aitken read his statement.

The CHAIRMAN. Mr. Aitken.

Mr. AITKEN. I might mention that the firm with which I am connected in Philadelphia render service in the main to small business, and we have been doing this work for over 30 years.

This statement will supplement statements by Mr. Bimson and Mr. Stewart and, therefore, it may in part be repetitious.

The impact of present taxation (Federal and State income taxation) is more of a retarding factor affecting investment in small business than possibly in larger units of business enterprise.

Expansion of small business usually comes from earnings, in that money for such purpose is difficult to obtain on any long-term basis from lending agencies (banks, etc.).

A small business having profits up to $25,000 is required to pay approximately 25 percent thereof in taxes. If such business were to expand, requiring additional capital of $25,000, it could not finance such expansion from retained earnings which would only amount to the $19,000 remaining after payment of taxes at the 25 percent rate.

Furthermore, it is entirely possible that some of this $19,000 might be required to pay off equipment obligations, the maturity of which would be much faster than the depreciation of such equipment.

This situation would not permit the small business to make any reserve for possible contingencies or to forestall the effect of a temporary recess in its business.

The fact that the small business is not able to retain much actual cash net earnings (after payment of taxes and equipment obligations mentioned above) for expansion and contingencies has an adverse effect on the minds of prospective investors, who would naturally demand the existence of a larger margin of safety than would be required if the investment were made in a large business enterprise.

If a small business could be permitted to deduct any dividends paid in determining the amount of taxable income, it would be a factor which would tend to encourage private investment in this class of business.

Again, if a small business were permitted a certain credit for money spent for additional equipment or plant in determining the amount of taxable income, it would further tend to encourage this sort of investment.

The depreciation allowances as set by the Bureau of Internal Revenue are based on the studies made by the Bureau (in Bulletin F following Treasury Decision 4422). These allowances are usually not realistic when it comes to small business because usually equipment is purchased to produce something in which there is a foreseeable profit for a limited time. However, depreciation allowances are not permitted on the economic use of such equipment but have been established by the Bureau of Internal Revenue on the anticipated physical life of such equipment.

Presently, there is a graduated scale of corporate income-tax rates running from 21 to 25 percent on profits up to $25,000. After this latter figure is reached in profits, then the rate jumps to 53 percent on any amount in excess of $25,000 up to $50,000.

It is felt by small business that to tax this amount at a rate in excess of the top rate (38 percent on incomes above $50,000) penalizes a class of taxpayer who can least afford it.

This advisory committee has previously recommended to the Secretary of Commerce that he use his influence to get the Treasury Department to clarify its position on section 102 of the Internal Revenue Code and to place the burden of proof on the Treasury Department. While it is felt that this section undoubtedly would not be invoked in case a small business uses profits for expansion, yet the threat of such a provision actually is an adverse factor in the mind of a prospective investor.

Summary: Therefore, the average investor considers these taxation matters as being adverse effects when it comes to the point of investment in a small business.

Thank you.

The CHAIRMAN. Thank you, sir.

Mr. MILLER. Senator, this committee in its deliberations have pretty well come to the conclusion that because of the impact of taxation and the lack of a realistic depreciation policy it is very difficult for small business, as we know it, to obtain what you might call equity capital. As a matter of fact, it might be said that small business really is not interested in equity capital in a great many instances because the business is owned by a family, or a small group of people who work there, and they do not want outside people.

We have come to the conclusion that if we have to wait for legislation to take care of the taxation problem and the other problems that are preventing capital from going into small business that small business will be left out in the cold and they never will get warm.

We think that the problem can be solved, at least largely solved, if there can be set up the proper scheme by which small business can borrow successfully its requirements from the standpoint of both short- and long-term loans.

We do not think there is anything set up today that will take care of small business in that regard. A great deal of the discussion and a great deal of work has been on that problem. We have worked out what we really believe is the solution of the problem of borrowing money on the part of small business, and we would like to present our solution to you now. Mr. Bimson will present it.

The CHAIRMAN. Very well, Mr. Bimson.

Mr. BIMSON. Small business, as defined by the Department of Commerce, constitutes about 90 percent of all business establishments in the country, accounts for the employment of about 45 percent of all people engaged in business and is responsible for about one-third of the dollar output of all business.

The CHAIRMAN. May I interrupt you at this time to ask if you have the definition of small business announced by the Department of Commerce.

Mr. BIMSON. Perhaps one of the men from the Department can quote it. I am sorry I cannot.

The CHAIRMAN. Mr. Kelly, do you have it? I think this is the spot in the record in which to insert it.

Mr. KELLY. The Department of Commerce defines small business as any independent enterprise, in the case of manufacturers, employing 100 or less people; a wholesale business doing $500,000 or less annual business; and a retail establishment doing $100,000 or less business; and independently operated by the owner-manager.

The CHAIRMAN. How long has that been the Department's definition of small business?

Mr. KELLY. I believe for about 3 years, Senator.

The CHAIRMAN. What was small business 4 years ago?

Mr. KELLY. Five hundred employees, without any regard to the difference between the character of the small businesses.

The CHAIRMAN. Does this definition which was announced 3 years ago satisfy the members of the small business advisory group?

Mr. RAGLAND. Not me.

The CHAIRMAN. Is there any other disagreement?

Mr. RAGLAND. It disqualifies me, Senator.

Mr. MILLER. I think, Senator, that you could make up any number of definitions of small business. I think that a small business in one type of work would be a big business as related to some other business.

The CHAIRMAN. Well, it is wholly an arbitrary division, is it not?

Mr. MILLER. It is, indeed.

The CHAIRMAN. All right, you may proceed, Mr. Bimson.

Mr. BIMSON. Small business, therefore, is of vital importance to our national economy and it is highly essential that all worthy small businesses have access to adequate sources of credit.

It is admittedly difficult for small businesses and particularly newly established small businesses to obtain financing. This is an understandable difficulty because investors and bankers know that these businesses are hazardous and that anyone investing in them or loaning money to them assumes abnormal risks.

Small businesses are always subject to a high rate of disappearance. Last year, for example, 370,000 businesses were discontinued. This was about 9 percent of a total of 3,976,400 businesses in the United States (Survey of Current Business for June 1949, pp. 21 and 22). The rate is rising steadily and is now nearly twice as high as in 1947.

A recession of business volume from the high levels of an inflationary period always creates business difficulties. Whenever inventories become top heavy, when sales and collections slow down, more capital is required. Businesses with inadequate capital to meet a period of recession have to obtain more capital or liquidate. Unfortunately, credit needs arising from these reasons occur at a time when investors and bankers are more than usually cautious and unwilling to assume abnormal risks. It is more than likely that as business failures increase there will be more and more complaints about businesses being forced to liquidate because of a lack of capital. It is wise to consider this problem before the need becomes too acute.

The initial capital requirements of most small businesses are met out of the savings of the proprietors. The Department of Commerce estimates that about two-thirds of the original investment in small businesses (those starting with less than $50,000) comes from the personal savings of the owners. Current working capital requirements, as distinguished from invested capital, are usually met by credit from the suppliers of raw commodities or processed goods, usually on a 30-day basis and by borrowing from local banks.

However, an important need of most small businesses is for longer-term credit for capital expenditures, such as purchase or modernization of plant, purchase of equipment and tools. While many small businesses do obtain term loans from banks for such purposes, it is difficult to obtain such loans unless the business has adequate equity capital or sufficient value in plant and equipment to secure longer term financing.

It is desirable that the private banking system be encouraged to finance small business, whether the need is for current working funds or for longer-term capital. Local banks having an intimate knowledge of local concerns—their personnel, their sources of supply, their outlets, their relationship to the local economy—are in a much better position to appraise the hazards and opportunities than a distant lending agency.

And the record of the private banking system indicates that banks are meeting these requirements in most instances. For example, a Federal Reserve Board study of November 1936 indicated that at that time the member banks had outstanding 671,000 business loans for $13,000,000,000. This represented one loan for every five businesses in existence.

One-third of these loans were unsecured, open credits, representing 54 percent of the total loaned. Two-thirds in number and 44 percent in amount were secured by inventories, equipment, plants, life insurance, endorsers, co-makers, etc. One-third of the total dollar amount of these loans were term loans. Ninety percent of these loans were made to businesses having assets of less than $250,000.

The small business credit committee of the American Bankers Association has, during the past several years, given excellent service in encouraging private banks to lend every aid and assistance to creditworthy small business.

In spite of all this, however, it is recognized that not all creditworthy businesses are able to secure adequate financing from the private banking system or from presently existing governmental agencies.

If it is the desire of Congress to give aid to small businesses which are unable to secure adequate credit; this should be done, we believe, not by the establishment of new and additional governmental lending agencies, but, rather, by action of Congress giving one or more existing agencies additional powers. The goal to be reached in any such action should be adequate short- and long-term credit for worthy small businesses, supplied through the cooperation of existing private banks and under conditions which will add no additional cost either through subsidies, administration expense, or losses, to the taxpayer.

We wish to propose that the Congress consider an effective way of supplying credit for small business by authorizing the establishment of a loan insurance plan patterned after the Federal Housing Administration method of insuring FHA title-I loans.

Under this plan, banks are authorized to make loans up to a reasonable limit for each borrower, and are required to withhold a small part of the interest charge which goes to a Government-managed insurance fund, out of which losses and all administrative expenses are paid. The contributions to this fund are credited separately to each lending bank and are accumulative, so that, if losses do not equal the insurance fund, the balance in the fund is held for use against losses in future loans. With a satisfactory loss experience, this fund grows until it may well cover a very high percentage of the total loans outstanding. As this fund becomes larger, the risk to the lender is correspondingly reduced, so that the lending agency may safely adopt a more liberal lending policy.

This plan has been successful in promoting a large volume of FHA title-I loans. Under this program, participating banks have been able to adopt very liberal lending policies and with no loss to the lender or to the Government.

This plan, if adopted for business loans, would instantly make available the resources and experience of the entire American banking system. It would make use of no Government funds, should cost the Government not one cent. It would place the responsibility for financing small business squarely upon the shoulders of the private banker, and would fill every legitimate credit need of small business. Although any one of several presently established Government lending agencies might be authorized by Congress to supervise and control this program, the RFC and/or the Federal Reserve System are probably best qualified for this assignment by their long record of lending money to business, and their already-established country-wide organizations.

In order that small banks with limited resources might be assured of adequate lending capacity to meet the needs of its own community, the agency selected should be authorized to purchase these loans upon demand of the lending bank, just as the RFC is now authorized to purchase real-estate loans through the instrumentality of one of its subsidiary corporations, the Federal National Mortgage Association. Also, to gain greater flexibility, the agency might be authorized to resell these loans to the original lender or other lending institutions.

The complaints so often heard about the difficulty of obtaining loans from the Federal Reserve System and the Reconstruction Finance Corporation result from inadequacy of present powers and inefficient administration and use of powers they now possess. Both agencies are too much entangled in red tape to make prompt decisions and speedy handling of applications possible. It takes a lawyer and an accountant and a very experienced banker to prepare the forms and exhibits necessary to get a loan from either one. Most small businesses and most small banks do not have available the technical knowledge to properly prepare an application for a loan. As a result of these conditions, many banks and many borrowers refuse to subject themselves to the ordeal of trying to get a loan from either agency.

Evidence of the inadequacy of these agencies is conclusively shown by the records of the RFC and the Federal Reserve banks in making loans to small business. At the present time, for example, the Federal Reserve banks have outstanding $1,843,000 of loans to all businesses, large and small. The RFC outstanding loans to business and industry, large and small, now totals $433,000,000. Compared to the present outstanding loans of all insured commercial banks, amounting to over $40,000,000,000, these loans by Government agencies are inadequately small.

Although it is not possible to tell what portion of these loans are made to small business, we have some indication in the figures given by Mr. Kaplan in his testimony before this committee. He quoted a report of the first 150,000 loans made by the Federal Reserve banks under section 13 B which showed that only 3.1 percent of the aggregate amount advanced was in loans of $10,000 or less. He also stated that the RFC, during the 9-year period from 1932 to 1941, made only $21,000,000 of loans to small business out of a total of $460,000,000 loaned.

Because of this record of governmental-lending agencies, we recommend that the Government agency selected to administer the plan we have suggested should not have the power to review the loan before it is made. The banker must have the sole right to make any loan he wishes to make so long as it meets certain simple qualifications set forth in the law. This is the basis upon which the FHA title-I loans are made. The only review of the loan made by the governmental agency would be made when, and only when, a claim was made for a recovery of a loss by payment from the insurance fund. This review would be made to see that the loan had been properly made to conform to the regulations and the law.

Let us here point out that FHA title I loans are now being made at the rate of $50,000,000 a month, and that last year the average loss on all such loans was about three-tenths of 1 percent of the principal. This indicates the popularity of this insurance principle and the soundness of placing the entire responsibility for the selection of loans upon the banker, without governmental review or interference.

Let us further point out that in a report recently made by Lester H. Thompson, Comptroller of the Federal Housing Authority, in volume 13, No. 4, of Insured Mortgage Portfolio, the quarterly publication of the Federal Housing Administration, he reviewed the experience of FHA title-I lending since its inception to the present time and stated:

> The results of the study indicate that title-I operations, with respect to insurance granted from July 1, 1939, to June 30, 1949, will be self-sustaining and will produce an excess of income and recoveries over claims and expenses in the amount of approximately 5.7 million dollars.

This means that in this 10-year period loans totaling $3,632,257,147 have been made without preview by the FHA and, after all losses have been paid and all administrative expenses have been paid, there will be left an estimated profit to the Government of $5,700,000. Is this not conclusive evidence of the soundness of this plan?

Now, it is true that the credit risks and hazards of loans to small business may be greater than they have proved to be under title I. But the principle remains the same. If an insurance premium of three-fourths of 1 percent of the principal is sufficient to cover losses and expenses of title-I loans, the only factor to be determined is the rate of insurance that would be adequate for loans to small business. This unknown factor requires careful study. We are inclined to believe a 1½ percent rate might be adequate, and this rate added to the interest rate charged for loans to small business would not be intolerable to them.

A maximum maturity of 10 years should be provided in order to care for long-term credit needs.

Perhaps an over-all limit in amount of outstanding loans should also be provided by Congress in the initial stages of the experiment.

And, it might be advisable for Congress to authorize the supervisory agency to set up a reserve fund against losses as a protection against excessive losses during the early experimental years of the plan until the accuracy of the predetermined insurance premium had been checked by experience.

If such a plan as here proposed were to be adopted by Congress, we believe it would adequately meet the need of small business for short-term and long-term credit, and would provide this credit eventually without loss to the Government or to the private bankers cooperating with the plan.

Thank you.

The CHAIRMAN. Thank you, Mr. Bimson.

I observe your statement on the first page of this suggestion that 370,000 businesses were discontinued in 1948. According to your first presentation, 394,700 businesses were established in 1948.

Mr. BIMSON. Yes.

The CHAIRMAN. Which means, of course, that there was a net gain in 1948 of only 24,700 businesses.

Mr. BIMSON. That is right.

The CHAIRMAN. Do you have any figures for the discontinuances during the previous years of that table which you set up on page 2 of your original statement?

The reason I ask that question, of course, is that we are concerned not so much with the establishment of new businesses as we are in the establishment of stable new businesses, businesses that are likely to be able to survive the shocks of economic life.

Mr. BIMSON. Senator, I have the report here and I think I can find that table in a few moments. Perhaps some of the men from the Department of Commerce know exactly where to turn to it. There is in this report I am referring to the statistics for the postwar years, both new beginnings and the closings of business.

The CHAIRMAN. Well, as a note to your statement, then, in the public record we will put in some reference to the discontinuance.[1]

Mr. BIMSON. I shall be glad to provide that, and I am sorry I cannot put my hands on it in this book.

The CHAIRMAN. That is all right.

Congressman Herter, do you care to ask any questions at this point?

Mr. HERTER. I would like to if I may.

The CHAIRMAN. Very well, sir.

Mr. HERTER. At the very outset of your testimony, Mr. Bimson, you mentioned the tax law and depreciation as being the two most vital matters you had in mind. You have also testified that the great majority of small business are made up of a few stockholders, usually individual personal savings, or the family, or a few that have been brought in.

Has your committee studied the possibility of having small business that is in the corporate form taxed as a partnership rather than as a corporation in order to avoid the double taxation that you complained about here particularly? I raise that question, if I may go on for a moment, for a reason I think would be interesting to the Senator. Recently I saw a group of small mining men who were out of business and appealing to Congress for subsidies in the form of price support. They reported that there would be absolutely no need of

[1] Mr. Bimson was referring to table VI, page 122, of joint committee print, Factors Affecting Volume and Stability of Private Investment.

their asking for such aid if it were not for the tax laws and the depreciation laws under which they had to operate, which made it impossible for them to operate, and they have gone out of business on that account. If these corporations, with few stockholders, as most of them were, were allowed to handle their taxes as a partnership and to handle their depreciation on an optional accelerated basis, they would not be coming to Congress for help of any kind whatsoever.

I am wondering whether your committee has given attention to that.

The CHAIRMAN. Before Mr. Bimson answers, I must say that the Congressman will probably be interested in the fact that tomorrow in New York the Director of the Bureau of Mines and some of his staff and representatives of the Committee on Interior and Insular Affairs, which brought in the bill to which you refer, will hold a conference to study this whole question of tax reform, particularly with respect to the mining industry.

Mr. BIMSON. I have little to say in answer to that, except that we have studied many of these various proposals for bringing relief. However, we have generally not been too specific in our recommendations about it, preferring rather to deal with some of the general principles involved and not get into too much the technical problem of working them out. That has been discussed in our general sessions. I am sure that no formal resolution or recommendation has been made on that particular point, however.

Mr. HERTER. I notice that your recommendations on accelerated depreciation do not attempt to draw any line between small or large businesses. Do you think it should be applicable to all business rather than to try to draw any definition as to where the limits would be reached in distinguishing the large from the small?

Mr. STEWART. In a general way, yes. Of course, it affords greater possibilities and greater advantages, as I attempted to outline, for small business.

The CHAIRMAN. What you said, Mr. Stewart, if I remember correctly, is that the large business currently is much better able to handle itself than small business under the present system?

Mr. STEWART. That is correct.

The CHAIRMAN. So that your primary concern is to find a rule of depreciation that will be appropriate for small business?

Mr. STEWART. That is right.

The CHAIRMAN. If no distinction were made in the rule between small business and large business, would not this disadvantage of small business be continued except at a different level, so to speak?

Mr. STEWART. No, sir; as I see it, I do not think so.

I think large businesses with their large stockholders' group in most cases set up a plan of extended depreciation; it would be done whether they are required to or not. In a lot of cases they would do this because they want to carry on the profit and keep their stock favorably on the market. And I do not think they would charge it off as quickly as a small business who owned their own business. I think small business would use accelerated depreciation more readily, although in some cases I am sure large businesses would, too.

In any case, it does not make any great deal of difference in ultimate tax revenue, as I see it.

The CHAIRMAN. Have you considered the desirability of making a distinction with respect to depreciation or with respect to the weight of taxation, for example, between the business which is owned and managed by the same persons and the larger business which is managed by managers rather than by the owners?

Mr. STEWART. We made such recommendations as exemptions of taxes up to a certain amount, or liberalization on the taxes of the first-earned money, which would, of course, benefit the smaller business. But that was not covered in this matter of depreciation. And depreciation as it is treated here, as I attempt to treat it, is a contributor to building up production of this country, keeping it strong, and keeping it a better country from every angle.

The CHAIRMAN. As pointed out by Mr. Aitken, for example, a small business having profits up to $25,000 has to pay from 21 to 25 percent in taxes; and then, when it gets a little bit larger, up to $50,000, the rate on a portion of the income may jump to the 53-percent rate. Would there be any objection to a scaling down of those rates for small business?

Mr. STEWART. No; I should not think there would be as far as small business is concerned.

The CHAIRMAN. Would it be an advantage?

Mr. STEWART. It would be an advantage.

Mr. AITKEN. It would be an equitable one.

The CHAIRMAN. Would it be regarded as favoritism for small business against the large, and would there be any objection to favoritism?

Mr. STEWART. There would be a favoritism, and there would probably be some objections, too. But it certainly would not be from the small-business men.

The CHAIRMAN. As I see this, it seems to me we are considering a tax system which was largely devised for the purpose of raising money quickly for financing the war. Now our objective should be for a tax system that would be geared to increased production, to increased development of little and local business, and increased stabilization of little and local business, on the theory that such a system would contribute far more to the general stabilization of a free-enterprise system than anything else we can do.

Mr. STEWART. I quite agree with you on that.

Mr. HERTER. May I ask a question, Mr. Chairman?

The CHAIRMAN. Yes.

Mr. HERTER. As I understand the 53 percent, that is an equalizing provision so as to bring earnings between $25,000 and $50,000 up to the 38-percent scale. Is that a correct statement?

The CHAIRMAN. Yes.

Mr. HERTER. It is not intended as a punitive thing on the $25,000 bracket.

Mr. MILLER. It more or less works out that way on small business. After all, your problem is merely that of being able to keep in the business the money you used to be able to keep there and on which you could grow. Under present tax laws you just cannot do that; there is not enough left.

Mr. HERTER. What you are really raising there is the difficulty of finding a stopping point as between small business and big business.

Mr. MILLER. I do not think that you have to differentiate between the small and the large business, except that a business that earns a certain amount of money should not pay as much taxes relatively as a business that earns a much larger amount of money. It would not make any difference if it was a big business and it had a bad year and it only made a little bit of money; it would be just as fair to that business to not be taxed to such a great extent.

Mr. HERTER. But at some point the Treasury would have to find a sliding scale to graduate the tax between 25 and 38 percent. It is merely a question of finding where the most equitable place should be; otherwise, you would have such a big jump.

If the 38 percent went on the entire earnings, if you earned $26,000, it would be better for you to throw away a thousand dollars. You would be better off. So somewhere there has got to be a graduated scale, and it is just the question of fixing it at some point; is it not?

Mr. MILLER. There is a graduated scale now, is there not, Jack, for all intents and purposes?

Mr. AITKEN. It seems to me that if the tax imposed on small corporations could be just on that basis, a graduated scale, it would remove, I think, this penalty provision of 53 percent which almost is a penalty provision against small companies. And it would convert it from a penalty provision to an equitable basis.

Mr. HERTER. May I ask one more question, Mr. Chairman?

The CHAIRMAN. Yes, indeed, Congressman Herter.

Mr. HERTER. In connection with the suggested set-up for guaranteeing loans for small business, you have suggested 1½ percent as an arbitrary figure which you think requires a good deal more study. By whom would that 1½ percent be paid, entirely by the borrower?

Mr. BIMSON. It is now so paid under FHA loans. We charge at a rate, say, of 6 percent, and 1½ percent of that would be remitted to the insuring or governmental agency, and 4½ percent would go to the banker who made the loan.

Mr. HERTER. Are not you going to have the same situation as now exists? If the charge for insuring is entirely paid for by the person going into business and none of it by the bank itself, the bank naturally will want to see every loan insured.

Mr. BIMSON. Well, I think that has not been a deterrent—I was trying to get the purpose of your question. It has not been a deterrent to volume in the FHA title I business. I presume you are not talking about deterrents, you are talking about the fact that all bankers would put those loans into this guaranty class, you mean?

Mr. HERTER. Yes. Why not, if it costs them nothing?

Mr. BIMSON. Well, it does.

Mr. HERTER. That is what I am inquiring about. I think it does cost them something. As this was suggested, it seemed you were indicating it would all come on the borrower.

Mr. BIMSON. I think you would find what would happen is they would be making loans they otherwise would not make, and as they made those loans, the new type of loan, of course, their earnings would increase. If they do not have incentive, they do not make them, it would be too much trouble. I am merely suggesting that percent of rate as one which would give the banker, perhaps, enough of a profit to cause him to want to make the loans. And yet that 4½, plus 1½, would not be too restrictive on the borrower. I think most small businesses who need money would be willing to pay the 6 percent if that were determined to be an adequate rate. They would pay more than that, as a matter of fact.

Mr. HERTER. Under the FHA, I think that the large number of loans made on that type of construction have represented very nearly 100 percent guarantee. I wonder if you would not get to 100 percent here.

Mr. BIMSON. It works out that way. If you have a good loan experience—for instance, in our bank, our loss on FHA title I loans averaged one-quarter of 1 percent. You see we have been setting up for 10 years three-quarters of 1 percent, so we happen to have a very substantial insurance reserve set up.

The CHAIRMAN. What do you think are the prospects that that reserve will continue after a few years?

Mr. BIMSON. It has been operating now for 10 years, Senator, and I do not think there is likelihood of the rate of loss being in excess of the insurance premium of three-quarters of 1 percent.

The CHAIRMAN. I have heard it stated by some supposed experts in the field that the Government insurance system under FHA title I has resulted in encouraging loans on property in excess of the real values of the property; that many homes have been built, particularly during the recent demand for new homes, and have been sold at excessive rates to their present owners—homes which may in a few years begin to show the many weaknesses in construction and become very much less valuable than the basis upon which they were originally appraised.

Mr. BIMSON. I think perhaps my reaction to that criticism, which I also have heard, is that the importance of it is considerably exaggerated. I think unquestionably during this period of high prices houses have been built at high cost and perhaps somewhat carelessly constructed. We would desire that were not true. But nevertheless, in general, I think throughout the country the Federal housing program has been a sound program and that the great majority of the houses have been fairly well built, at high cost it is true.

The CHAIRMAN. Of course, as a resident of Arizona, you had no experience in that terrible western blizzard of last February, which filled the papers of the country. I can tell you that in the area visited by that storm there were many new houses into which the snow blew almost as though the walls did not exist at all, whereas old houses which had been constructed for years withstood both the wind and the snow. That, of course, is perhaps just a local situation.

Mr. BIMSON. Coming from Arizona, Senator, where we have only sunshine in winter, you would not expect me to have that experience.

The CHAIRMAN. I understand that, but, nevertheless, the fact remains that some of these new structures under FHA insurance may turn out to be "inflation slums" after a few years. The question then arises in my mind whether Government insurance will have turned out to be such a valuable device.

Now, the reason I am raising that question is to ask why you think private insurance has not gone into this field of insuring business loans. Why would it not be much better for private enterprise to establish a privately owned business loan insurance system instead of turning to the Government? We hear so much criticism of the intervention of Government in business affairs.

Now, you will remember at the beginning of the war the necessity, or desirability rather, of setting up a war-risk insurance system was widely discussed. Private enterprise in the insurance business would not touch it. Finally, the RFC had to go into the business. The RFC, as a consequence, earned a very tidy profit for the Government, which might have been earned by private capital if it had been willing to risk the establishment of a privately owned and managed insurance system. The same might be true with respect to business insurance. What is your view of that?

Mr. BIMSON. In this instance, I think the governmental agency would be acting as little more than a trustee of these funds, since the selection of the loans under this plan would be made entirely by the private banker. I suppose, theoretically, it ought to be possible to create another trustee, a great trust company, or great insurance company, as a trustee for these funds. I doubt, however, if it could be done that way. I am not myself anxious to encourage Government to get into business, but I think there are some things where the Government can serve a purpose, a Nation-wide purpose of this sort, with propriety. As to this plan I have outlined, I think it can be done without any cost to the taxpayer, but I do think it needs a central control and a central trusteeship to handle these funds, and that it could be done better by the Government than by any private corporation.

Mr. MILLER. It seems to me it should be pointed out that under this plan the Government is not insuring these loans.

The CHAIRMAN. Are there any questions, Mr. Buchanan?

Mr. BUCHANAN. In discussing business failures, you indicated that the current rate is running about twice as high as they were in 1947. The 1949 figure, I take it, is in excess of the 1948 figure. That is, so far as any comparable period is concerned.

Mr. BIMSON. I am not too sure I can quote the figures accurately, but that, roughly, is about the way it is running if you will look at the tables of busines failures. I am sorry I do not have those figures. I think we can get those figures supporting it for you.

Mr. BUCHANAN. Are the figures for 1949 unduly alarming in contrast to 1948?

Mr. BIMSON. No; there has been a rather gentle but steady increase in the number of business failures reported from month to month by the credit agencies. I will be glad to submit those figures to the committee, if you would like to have them.

Mr. BUCHANAN. The 3-year comparison.

(The information requested above is as follows:)

Business failures—Industrial and commercial failures

Month	1947	1948	1949	Month	1947	1948	1949
January	202	356	566	July	299	420	719
February	238	417	685	August	287	439	810
March	254	477	849	September	292	398	732
April	277	404	877	October	336	461	--------
May	378	426	776	November	313	460	--------
June	283	463	828	December	317	531	--------

The CHAIRMAN. It was interested in your discussion of depreciation as a necessary method of relieving the position of small business.

As I listened to you, it seemed to me that you were suggesting that there should not be any particular formula but that each businessman should in effect be allowed to make his own arrangements about depreciation. Is that correct?

Mr. STEWART. That is correct, but the previous recommendation we had made, as I recall it, was a 5-year program of 20 percent depreciation, similar to the certificate of necessity that was used during the war to encourage industry or to enable industry to make this type of expansion I referred to, and that was more specific. I was more general in this discussion, and I did not specify the limitations as to time, or anything of that kind.

The CHAIRMAN. Do you not think it would be necessary to have a regular rule to which all would adhere?

Mr. STEWART. Personally, I do not think that would be necessary, because you can only charge it off once. You cannot charge off any more than you capitalize or your purchase price. If business were to charge it all off in 1 year, Government would get the fruits of the production of that equipment immediately after the next year.

The CHAIRMAN. Is it your general principle, then, that depreciation should be allowed for expenditures for plant expansion during the period of anticipated earnings as a result of the expansion?

Mr. STEWART. Yes; and we went one step further and stated in this previous recommendation that when you once set up a schedule of depreciation on a capitalization, that you could not change your pace; you had to stick to it. Whether you might elect to charge it off in 5 years or 10 years or whatever number of years that you elected to do it, you would set that, and that would be your final arrangement through the period of that amortization or charge-off of that equipment.

The CHAIRMAN. Are all the other members of the council here in agreement upon that?

Mr. STEWART. I hope so.

The CHAIRMAN. Any comment from any of you gentlemen about it? Should it be a definite rule laid down in the law?

Mr. KALETZKI. It was pointed out in the discussion that the rate of depreciation was dependent upon the requirement of each industry. In each specific industry, once the enterprise had established a rate of depreciation, they would stand by that rate for the particular transaction.

The CHAIRMAN. But he would be free to establish his own rate of depreciation?

Mr. KALETZKI. In agreement with the internal revenue people.

The CHAIRMAN. What would you provide——

Mr. STEWART. No agreement.

The CHAIRMAN. What would you provide to control the discretion of the internal revenue people? Would not that be giving the internal revenue collector a tremendous control over the investment and expansion?

Mr. KALETZKI. Except that the individual enterpriser has to deal with his own program. If he determines that the nature of his business is such that he can amortize a piece of equipment in a 5-year period, he is best equipped to know that that is so; he establishes that with the Internal Revenue Bureau, and they agree to that with him.

The CHAIRMAN. But do I understand you to suggest that the Internal Revenue Bureau should have the right to say to such individual businessmen, "Well, nevertheless, although you believe you can and should be permitted to amortize or depreciate during 5 years, it is our judgment that you ought to take 10 years, and 10 years it is going to be." You do not want that, do you?

Mr. STEWART. No. That is just what we do not want.

Mr. KALETZKI. We want the individual enterpriser to establish a rate of amortization that is going to permit him to operate his business to the best advantage of his own business and the Government as well.

The CHAIRMAN. That is why I feel that if such a change of law should be made, it ought to be made so definite and certain that nobody in the Internal Revenue Bureau would have authority to change it.

Mr. STEWART. That is correct.

The CHAIRMAN. Otherwise, it would be worthless, it seems to me.

Mr. STEWART. It would be worse than that. It would be dangerous because you would think you had certain latitudes and set up your plans on that and have it disputed and then upset your entire program. You set it up the first year, and there you are; and that is what you stay with.

Mr. KALETZKI. That is the point. You set up your program the first year, and you live with it in accordance with the requirements of your business. That does not mean a 5-year amortization program would apply in all businesses. In a specific business, a 5-year program may be entirely desirable; and in other businesses, a 2-year program may be desirable. Whatever is considered most equitable for all elements concerned would be established and agreed upon and would be lived with.

The CHAIRMAN. Wouldn't you be much more likely to get legislation from Congress if you were asking merely for authority upon the part of the expanding small business to choose a particular period of depreciation between X years and Y years and then eliminate all possibility of discretion?

Mr. STEWART. That would be a compromise, but I think it would not be a bad compromise, because I think the 5-year program would give you a pretty good period to work in, if you could get it down to as much as 5 years. It would be better for the smaller outfit to get it in one or two or three on up.

The CHAIRMAN. Early this week—in fact, Monday morning—the Secretary of Commerce released for general publication a report from the Bureau of the Census showing the concentration of business in the United States.

This document, which is reather lengthy, concludes with the following statement with respect to table 5:

> This table summarizes the changes which may be observed in concentration ratios between 1935 and 1947 for those industries for which the data permit direct comparison. Such comparisons can be made for the first 4 companies in 1930 of the 452 industries, while comparisons are possible for the first 8 companies in 133 industries.

I might say here parenthetically that the significance of the phrase "first four companies" and "first eight companies" is simply that the table undertakes to show what percentage of business in particular industries the largest four companies handled in 1935 and what the change was in 1947, and the same with respect to the first eight. Then, the statement goes on:

> Lack of comparability in other cases is due to differences in industry classifications in the two censuses. In terms of numbers of industries alone, without regard to their size or importance, the data show a somewhat larger number of decreases than increases. Inspection of table 1 shows that in the industries over $500,000,000, there are somewhat more increases than decreases, while the reverse is true for industries under $500,000,000.

Now, of course, this slight decrease in the industries, less than 100,000,000 in 1947 as compared with 1935, is probably due largely to the greatly increased number of businesses since the war, many of which were financed by the Government through GI loans and what have you.

So that, actually, the table shows on the whole that the rate of concentration in American industry has not fallen off. For example, this table here shows in some cases a concentration running from 51 percent for the first four companies to as high as 90 percent. For example, in the cigarette industry the first four companies in 1935 did 89.7 percent of all the cigarette business of the country. In 1947 they did 90.4 percent.

The point I make in citing these figures is that it seems to me, in the light of this ratio of concentration, it is extremely important to find a practicable and speedy method of providing incentives through taxation for the investment of private capital in small business in a manner that will tend to stabilize that investment.

There is no particular sense in getting money invested in small business if that small business is to be gobbled up presently by large units in the industry. We not only have to promote investments, but we have to stabilize the conditions under which the investment is made effective.

Do you not agree?

Mr. Stewart. I certainly do, sir.

The Chairman. Are there any other comments on this depreciation? How about the professor from Harvard?

Mr. Mace. Sir, that is really putting me on the spot. I would like to make a slight qualification to something that might be misinterpreted. You indicated that small business might be gobbled up by large businesses. I am not sure I would say it quite that way. I think the tax situation encourages small businesses to approach larger businesses to buy them out.

The Chairman. I agree.

Mr. Mace. I do not believe I would say large business gobbles them up. Small business goes to big business and says, "I can get a maximum 25 percent capital-gains tax on this. How about buying me out?" And maybe he takes a management contract for 5 years or maybe he gets out altogether.

The Chairman. I did not mean to imply the initiative at all. It is quite true, I think, that the tax system particularly, sometimes the inheritance-tax system, encourages the owner of a new independent enterprise to sell out.

Mr. Mace. As a fellow who is interested in teaching the problems of starting and managing small businesses, I think it is very important that we maintain recognition of the interrelationship of large, medium-sized, and small businesses, and not think they are necessarily in conflict. I think they are interdependent and interrelated.

Here is a recommendation which the Small Business Advisory Committee passed on to the Secretary of Commerce and which I understand was passed on to the Treasury with regard to this depreciation policy Mr. Stewart was talking about, and I should like to read it. I think it is a reasonable semblance to what we prepared and was then transmitted to the Treasury:

> A recommendation on a sound depreciation policy for small business has been prepared and furnished the Treasury Department. This recommendation proposed that the businessman should be allowed to choose his own schedule, but then must stay with it. Second, that no rate less than 5 years could be selected unless the physical life of the equipment was actually less than 5 years.

We do not have a formal statement of that, but that is the sense of our previous resolution. Is that right?

Mr. Stewart. Yes.

Mr. Mace. So that once the businessman has made that determination, that is it.

The Chairman. Is that still the recommendation that you make?

Mr. Mace. Yes, sir.

Mr. Stewart. Yes.

Mr. Miller. Yes.

Mr. Stewart. There will be a recommendation that will go in tomorrow, and it will probably follow that same program that we set up before in the previous recommendation.

A Sound Depreciation Policy for Small Business

At its October 1948 meeting the SBAC adopted a tax recommendation to the effect that—

"A more flexible depreciation policy should be adopted so as to permit greater latitude for managerial judgment."

The appropriateness of this recommendation and the needs for its adoption can be demonstrated by an analysis of current tax practices in respect to depreciation.

Section 23 of the Internal Revenue Code provides that "in computing net income there shall be allowed as deductions: (1) Depreciation—a reasonable allowance for the exhaustion, wear and tear (including reasonable amount for obsolescence)— * * *"

Nowhere in the code is any more specific statement made and nothing is said as to methods and amounts. The regulations appear to permit a regular deduction for depreciation and ordinary obsolescence to be computed "in accordance with a reasonably consistent plan (not necessarily at a uniform rate) whereby the aggregate of the amounts so set aside, plus the salvage value, will, at the end of the useful life of the depreciable property, equal the cost or other basis * * *"

Another provision of the regulations is that "the capital sum to be recovered shall be charged off over the useful life of the property, either in equal annual installments or in accordance with any other recognized trade practice, such as an apportionment of the capital sum over units of production. Whatever plan or method of apportionment is adopted must be reasonable and must have due regard to operating conditions during the taxable period. The reasonableness of any claim for depreciation shall be determined upon the conditions known to exist at the end of the period for which the return is made."

There would seem to be little to criticize in the laws and regulations unless it be the limitation "in accordance with any other recognized trade practice." This rule reduces the opportunity for experimentation and forces all management decision into the conventional pattern. While the regulations permit unit of product and hours of use basis for computing depreciation, the fact remains that the straight-time basis is virtually required except in most unusual cases. Moreover, the length of life tables established in the Bureau of Internal Revenue's Bulletin F do not provide adequate allowances for obsolescence or management policy in reference to rapidity of replacement. Deviations from the rates established in Bulletin F are reported to require exceptionally complete verification by the taxpayer.

Businessmen say that, prior to 1934, the Bureau's policy toward depreciation was comparatively liberal and recognized almost any reasonable charge. Under such circumstances businessmen were free to use such depreciation rates as their rates of use or estimates of life indicated. In 1934, the Bureau adopted the policy of requiring the taxpayer to prove the validity of depreciation charges. This changed emphasis was done entirely as a means of tightening up the tax system and increasing the tax revenue obtained from the nearly prostrate business system. The policy is still in effect and results in a disallowance of charges which differ from those based on Bulletin F unless the taxpayer has sufficiently detailed records to satisfy the agent in charge. The degree of proof demanded of the taxpayer is so absolute as to make it almost impossible to use any depreciation allowance which does not conform to the opinions of the revenue agent.

Taxpayers have had the experience of having the revenue agent object to the rates used and then revise all the open years. The following year another audit is made, the rates revised in light of experience, and the open years adjusted again. In spite of the fact two of these years were revised to conform to agent opinion a year earlier. As a result of such practices, the annual audit often becomes more or less of a bargaining affair—one that may have cost the Government much revenue during the high tax years. This is true because the Bureau policy during the 1930's kept capital accounts at higher levels than might otherwise have been the case. These higher amounts were available for depreciation purposes during the high tax years beginning with the war period, with consequent reductions in tax liabilities.

The Bureau's attitude is understandable in terms of tax revenues for the current year; it is not so easily understood in terms of longer periods of time. As long as depreciation is limited to the asset's cost, it can be recovered only once. If the capital value is depreciated this year, it cannot be a deduction next year. If the businessman were allowed to adopt his own depreciation policies, this source of conflict between the Bureau and management policy would be removed. The field agent's audit could be limited to determining the fact that an asset had not been depreciated more than 100 percent—which would be a far simpler and less debatable matter.

A further advantage of a policy of flexibility would be the solution of the obsolescence problem. While the Internal Revenue Code provides that the allowances for depreciation should include a factor for obsolescence, there is widespread doubt as to whether or not this is actually done. Most businessmen contend that the Bureau's agents hold strictly to physical life data on depreciable assets and will not permit any provision for obsolescence unless the equipment is actually retired before the end of its physically useful life. To the extent this policy is followed, it discourages continuous modernization of productive capacity by making its financing more difficult.

It must be admitted that obsolescence is not easy to calculate. Technological progress goes on continuously but at a variable rate. This rate is determined in part by the accident of invention and in part by the demand for goods and services, as well as the varying cost conditions under which those goods and services are produced. Moreover, to a considerable degree, obsolescence is a function of management policy.

Production can be carried on with old equipment, with more rejected products, and with more labor Or it can be carried on with the latest equipment, with a better or more uniform product, and with less labor expense. It is a management prerogative to determine where to operate between the two policy extremes. The choice will depend upon financial strength and personal attitude. Both are conditioned by tax policies of the governments. With high tax rates and low allowances for depreciation (including obsolescence), the smaller concerns find their financial ability to keep modernized seriously restricted. In addition, their willingness to modernize is reduced. The Senate Small Business Committee reached the conclusion in its hearings last year that businessmen will not make investments in new or expanded facilities unless they recover that investment in 3 to 5 years' time. The period is not short because equipment is usually so short lived. It is because longer periods involve greater risks both in terms of business volume and of obsolescence. To be reasonably safe, the businessman must recover the value of equipment through depreciation charges or savings in cost in a time far shorter than the life periods specified by the Bureau of Internal Revenue. If the business could recover a greater portion of the outlay through tax savings, the period of time needed to make the amortization would be reduced, as well as made more certain.

Let us suppose for the moment, as an extreme case, that the Government adopted a policy of "free" depreciation, i. e., a policy wherein the businessman could depreciate his assets in any way he chose so long as he recovered only the original cost, what results could be expected to follow? This assumption is not so extreme in that it is the actual policy in Sweden, which is usually thought of as being a progressive country.

Under a free policy some businesses would depreciate their capital assets as rapidly as earnings would permit. A few would continue to use the assets until they fell apart. Others would replace equipment as fast as new improvements were developed. Such concerns would always be modernized—never modernizing. Their productivity would be higher, their incomes higher, and their working conditions better. The competitive leadership of this group would force the adoption of a similar policy in varying degrees throughout the business world.

The benefits to the country would be immeasurable. More goods and better goods would be produced at less cost both in money and in human effort. Employment in the heavy industries would be more uniform. Small business which is typically undercapitalized would obtain a measure of relief and encouragement, its financial situation would be improved materially, and productivity would be higher.

Any liberalizing of depreciation practices is opposed principally because it would result in an initial reduction in taxes. Undoubtedly the first year (or possibly the first few years) would see increases in depreciation charges and reductions in taxable income. Thus for a period the Federal budgetary situation would be made more difficult. But once the transition had been completed, tax yields should be raised rather than lowered, and the long-range implications should be as beneficial to the Federal Treasury as to the business community. In addition, the chief bone of contention between the Treasury and business would be removed.

The other objection is that businessmen would try to regulate their depreciation charges so as to be high in years of high tax rates and lower in years of low tax rates. If tax rates varied materially from year to year, this objection would have some validity. However, no businessman expects any important reduction in tax rates in the foreseeable future, and few would attempt to forecast fluctuations in governmental requirements. Moreover, a policy of flexibility could require that it be consistently applied. Under such a procedure, any rate of depreciation could be adopted, but once adopted it could be changed only with Government approval.

When the foregoing points are considered, the propriety of the SBAC's 1948 recommendation is apparent. In light of further study it requires only minor changes to make it a sound policy for the country and for business.

It is recommended that the Government grant business full flexibility in the selection of depreciation rates within the limitations that—

(*a*) no rate can be changed after its adoption without Government approval, and

(*b*) no rate can exceed 20 percent unless the usual physical life of the asset is less than 5 years.

The Chairman. Mr. Stevenson, do you care to make any comment? We want to get the academic view.

Mr. Stevenson. We realize the importance of entrance into business as a very important element in the development of our economy; so I have been very much interested in the comments that have been made.

I think I would go further than some of my colleagues in the degree of discrimination allowed the individual businessman in choosing his period of depreciation. I would go the whole length. If it is essential to carry out the particular project he has in mind to write it off in 1 year, I would go the whole length for 1 year. The important thing is that, when the capital asset is written off, it is written off for good, and the advantage that may be obtained by continuing the production with that particular piece of equipment results in added income in future years. The important thing is to charge it off just once.

Mr. HERTER. When you speak of writing it off in 1 year, have you in mind the writing off of all physical assets or he could distinguish as between different physical assets? He could write one off in a year, another in 5 years, another in 10 years; is that right?

Mr. STEVENSON. Exactly.

Mr. HERTER. If you are going to make this applicable to little and large business at the same time, if you are going to give that same permission to a vast corporation, the complexity of their returns would be really something to check, would it not?

Mr. STEVENSON. Probably, but in the case of the large enterprise, as Ross mentioned, they are likely to be looking toward the stabilization of their earnings over a period, and I doubt if they would make as much use of it as the smaller enterprise.

Mr. HERTER. If you had two identical lathes, you would not write one off in 1 year and the other in a period of 5 years, would you?

Mr. STEVENSON. No.

Mr. HERTER. Excuse me. I did not mean to interrupt.

Mr. STEVENSON. I think that covers the main comment with respect to depreciation.

The CHAIRMAN. It is recognized, is it not, that the small business is at a great disadvantage compared with the larger business in attempting to finance itself out of retained earnings?

Mr. STEVENSON. That is correct.

The CHAIRMAN. And it is because of that difficulty primarily that you urge this more favorable rule of depreciation?

Mr. STEVENSON. Yes.

The CHAIRMAN. Well, would you agree that because the larger company does have a better opportunity to finance itself out of retained earnings, that that difference should be borne in mind in creating this new depreciation policy?

In other words, setting up a definite class to which the more favorable depreciation policy should be allowed for the express purpose of encouraging the growth, the stable growth of small business; is that right?

Mr. STEVENSON. I personally would have some question as to that policy. I think that the rules should be generalized. I feel that the benefits would accrue primarily to small enterprises, but in setting up the legislative program, I would not distinguish between the small and large. I do not think we ought to get into a program that in a sense subsidizes any section of the business community.

I do not know if that answers your question.

The CHAIRMAN. Yes, it makes your position quite clear. There is no doubt about that.

Are there are any other comments by any other members?

Mr. WEAVER. Senator, you have heard from the academic side of the thing. I wanted to mention, more by illustration of the points that were brought up here, that in our own business, which is certainly a small business, a corporation, we have had really very severe financial problems. Yet during a normal growth and I believe operating our business policies in a satisfactory way, we have been put into the position of having to borrow on difficult terms and on a difficult short-term basis. Initially to get capital, and then, as we are coming nearer a position of making a profit, we are burdened extensively by the fact that the minute we get into even a relatively small-profit bracket, the tax situation is such that we cannot retire our debts which were accumulated in arriving at that point. In other words, initially if we could have had a more liberal borrowing opportunity and during that period have had an opportunity to depreciate on the most sound basis for our individual company, and have the tax help in addition, I firmly believe we would have virtually no financial problems in the sense that we have now.

Now, naturally, you always have some, and there are going to be difficulties, but I mean as far as the sort of unconquerable type of thing. In spite of the fact that you may be running your business well, be well organized, selling at a profit, operating efficiently, et cetera, you still have these burdens which cannot be overcome because of the general economic situation.

The CHAIRMAN. Well, is it your opinion that the present tax system, particularly in its failure to have these provisions which have been under discussion, operates as a deterrent to the expansion of business?

Mr. WEAVER. To give another specific example: In 1948, our little company—. Well, to go back one step further, our company, when I came there in 1945, was doing about $150,000 worth of business a year. In that year I arrived it lost $25,000 doing it, and it was in bad shape, and we had to virtually rebuild the company.

Well, in 1948 we did somewhat over a half million dollars' worth of business but at less than 3-percent net profit. Our profit before taxes was somewhere in the neighborhood of $16,000, because of the problems involved in organizing the business, and of that $16,000 we had to pay $4,000 in income taxes; and yet we had to borrow considerable amounts of money during that period and were trying to retire the thing in the normal way such as a mortgage.

Then, in the early part of 1949, when a slump came, that $4,000 would have made a tremendous amount of difference in our being able to sustain a difficult period. As it was, we did get through that difficult period, but several companies similar to ours in our own industry actually went out of business for almost that reason. They made more profit than we in 1948, but paid a higher tax, and then when the break came they were what you would call marginal companies. We had to grab every reserve we could, and that would have been one.

For the sake of argument, next year we will say we make $50,000, which would be very nice, but for the sake of the example we will assume that. Then, we automatically come into this high rate of taxation, and we do not have enough left even to begin to retire the debts we have accumulated to get to that point.

Mr. BUCHANAN. What type of business?

Mr. WEAVER. Porcelain enamel, a jobbing business.

Mr. BUCHANAN. In what State?

Mr. WEAVER. Massachusetts. We do signs and store fronts and stove parts, and things of that nature. It is a jobbing business.

Mr. HERTER. Isn't your problem essentially one of changing the law in respect to carrying forward losses incurred from year to year?

Mr. WEAVER. It would be if you could carry it forward far enough. For example, we had a carry-forward in the year we lost $25,000;

you get the thing the following year, but the minute you have a profitable year, in our case the build-up, by indebtedness, to get to that point is such that it will take more than just a few years to help retire our indebtedness.

The CHAIRMAN. Mr. Scoll?

Mr. SCOLL. I would like to ask Dr. Stevenson a question on accelerated depreciation. According to reliable figures which the staff of the committee have seen, the depreciation deductions in 1948 for all corporations alone amounted to about $5,000,000,000—roughly, one-sixth of the net income before taxes. That, of course, does not take into account depreciation eligible for income-tax deductions by individuals and unincorporated enterprises. But let's take the $5,000,000,000. If we accelerate depreciation and let us say it resulted in relieving half of that for taxation, $2,500,000,000, that would mean that the Treasury would lose about $950,000,000 in taxes.

Mr. STEVENSON. In the year in which that was done.

Mr. SCOLL. How would you make up that revenue?

Mr. STEVENSON. Certainly, in the following years if that equipment were productively used, it would result in higher income. It would be a cost in the first year.

Mr. SCOLL. It would be made up if the level of corporate income were high enough to yield that amount of return.

Mr. STEVENSON. That is right.

Mr. STEWART. If it did not, they would go broke otherwise; so you would be in bad shape anyway. Here you are trying to keep them in business, and they will work out if you give them a fighting chance.

Mr. MILLER. I wonder if your figures show the amount of money that was spent in improvements as far as capital expenditures were concerned during that same period of time.

Mr. SCOLL. You mean for 1948?

Mr. MILLER. Yes. You say there was a depreciation charge of $5,000,000,000.

Mr. SCOLL. I do not have the figure for new capital investment for that year.

Mr. MILLER. It is an awfully important thing to small business.

Mr. HERTER. It was around $16,000,000,000.

Mr. MILLER. The impact of that on small business is very, very serious, because the lathe they bought 10 years ago and depreciated at the rate of maybe $200 a year now costs them $3,000, and it is a serious problem. They just do not have the money to make the replacements.

Mr. SCOLL. I would like to ask Mr. Stewart a question on his outline here. This program of accelerated depreciation—would you apply that to old equipment as well as new?

Mr. STEWART. You mean something that was already capitalized, that you have at the present time?

Mr. SCOLL. Suppose you have machinery that is already half depreciated. Would you apply your program to existing equipment or just to new equipment?

Mr. STEWART. You would have a certain amount capitalized on your books that had not been depreciated off according to the tax regulations as they now stand. I would say that the proper and probably the most usable way to do that would be to allow them to charge off that which was still on their books as capital equipment. If they get it all off, what of it?

Mr. SCOLL. At what rate?

Mr. STEWART. Whatever rate they may elect. That is what we would like to have. Of course, that might not be the thing we will get, but I cannot see where it would make any difference, because business will not get any more than that anyway, and the Government will collect it ultimately down the line.

Mr. SCOLL. Wouldn't it make for different depreciation rates on the same equipment as between different taxpayers?

Mr. STEWART. Sure, certainly, that is right. Some fellow may not like to charge it off, and he may want 20 years for his accounting reasons or his stockholders' reasons or some other. That is up to him. Another man may want to charge it off in a year. It is up to him, too.

Mr. SCOLL. I would like to ask Mr. Aitken a question about his summary. On this question of the burden of proof on section 102, your paper says you think the burden of proof should be on the Treasury Department.

Mr. AITKEN. Yes.

Mr. SCOLL. Why do you say that?

Mr. AITKEN. Well, at the present time the Treasury Department can allege that section 102 applies, and the burden of proof is on the taxpayer.

Mr. SCOLL. That is right, so the taxpayer has to prove that his so-called illegal accumulations were for a proper expansion corporate purpose or necessary reserves, and if he can prove it, he is able to keep it. That is present law, and you want to change it and make the Treasury prove that what he has done with his accumulated earnings or retained earnings is illegal.

Mr. AITKEN. The idea was to have the Treasury prove that he intended to withhold taxes from the Government.

Mr. SCOLL. Do you not think that would make it a little tough on the Treasury Department to try to prove the intent of the taxpayer?

Mr. AITKEN. The Treasury Department at the present time with respect to depreciation rates has made studies, and the taxpayer cannot prove otherwise.

Mr. SCOLL. Depreciation is a matter of the opinion of many men. What a taxpayer intends to do with his earnings is what he has in his own mind. Do you not think there is a difference?

Mr. AITKEN. I have regarded section 102 as a penalty clause and for the Treasury Department to say, "We think that you intended," rather than to know that they intended, I think that puts an undue burden on the taxpayer.

Mr. SCOLL. Can you name specific cases where the application of section 102 has actually resulted in hardship or is it the threat of the application that is worrying?

Mr. AITKEN. I think there is one case that was rendered against the taxpayer, the Trico Co., in which I think the actual tax was levied against that company amounted to more than the earnings.

Mr. SCOLL. We are going back to the question of the intent and whether or not the tax was fairly assessed regardless of the amount. That is my question. Do you know of cases where the tax was unfairly assessed, in a case where the earnings, we will say, were being used for what would normally be accepted as a good business reserve purpose.

Mr. AITKEN. Not in my experience.

Mr. SCOLL. You do not know of any?

Mr. AITKEN. No, but it is a threat as far as the general situation is concerned with respect particularly to investors.

Mr. SCOLL. That is my question—whether it was more a threat than an actual hardship.

The CHAIRMAN. May I develop that threat angle just a little bit more? Your statement, Mr. Aitken, contained this sentence on page 2 the last sentence before the summary:

> While it is felt that this section undoubtedly would not be invoked in case a small business uses profits for expansion, yet the threat of such a provision would be an adverse factor in the mind of a prospective investor.

Now, that statement is different, of course, from a statement that section 102 acts as a deterrent to the small-business man himself. This is merely a statement that it acts as a deterrent to the investor. You made that distinction intentionally, did you?

Mr. AITKEN. I did.

The CHAIRMAN. So that as far as your experience goes, then, you feel that section 102 would not be invoked in the case of the investment of profits for expansion of a small business?

Mr. AITKEN. That is right.

The CHAIRMAN. But you do think that the investors, wondering whether it would or would not, just hang back?

Mr. AITKEN. That is right.

Mr. SCOLL. I would like to ask Mr. Bimson a question or two on his proposed plan for small business. You have drawn extensively on the FHA title I insurance system. Now, the type of business loan that you are talking about or that we are talking about would not be a secured loan, would it?

Mr. BIMSON. Might be, yes. If security could be obtained, a banker would obtain that security.

Mr. SCOLL. Normally if security is available, the borrower, small or big, can today generally raise money on the security; is that right?

Mr. BIMSON. It depends on the type of security. If it is plant or equipment involving a long-term loan, the banker would have in mind that there are bank examiners that would criticize his loan, and he may not make the loan. It depends on the type of security, whether it is a liquid type of security or whether it is not.

Mr. SCOLL. Now, the FHA loans are being made on residences, made on security that is considered fairly liquid.

Mr. BIMSON. Under title I there is no security offered. Title II is the mortgage loan and title I is the so-called repair and rehabilitation loan. There is no security offered.

Mr. SCOLL. Those loans are not large in individual amount.

Mr. BIMSON. $2,500 is the limit to one borrower, except on one class where $3,000 is the limit.

Mr. SCOLL. There the lender still has not only the wages, the earnings of the borrower, but if need be, he could levy execution on the real estate. He does not actually take a mortgage, but he could always get a mortgage and levy against the house.

Mr. STEWART. Not in Texas.

Mr. BIMSON. That would usually be a possibility.

Mr. Scoll. So in back of the banker's mind is the knowledge that he is dealing with a home owner and a wage earner, so that by and large he has some pretty good security.

Mr. Bimson. I think you are going too far in drawing that conclusion. I think generally there is practically no security except a very removed distant security that can be obtained only by legal process or some difficulty. It is not good security definitely.

Mr. Scoll. But it is better security than an ordinary business loan would be.

Mr. Bimson. No; I think it would be less good.

Mr. Scoll. You think it would be less attractive?

Mr. Bimson. Under title I you can obtain a loan to repair a house that is already mortgaged to the hilt, and that is sometimes done.

Mr. Scoll. Generally speaking, when we are talking about small business, what most of them need is equity money rather than loans; is it not?

Mr. Bimson. No; I do not think so. I think the need is for funds, for money.

Mr. Scoll. Long-term money.

Mr. Bimson. Or short. Whichever it may be. I do not think the great need is for equity money. Personally, I do not believe our experience would indicate that. They want money. They do not care how they get it, and frequently they would resist trying to dissipate their own single ownership by a sale of a share in the business.

Mr. Scoll. If they could get equity money without diluting their ownership, most of them would prefer equity money to debt, would they not?

Mr. Bimson. I do not know how that could be done very well. By equity money we usually mean common stock or a share in the business.

Mr. Scoll. Or preferred stock.

Mr. Bimson. Preferred stock is of no use.

Mr. Scoll. What do you think of the Kaplan proposal?

Mr. Bimson. I think it has one or two weaknesses. We pointed out it will not be necessary to create any new corporation or organization to do that. Secondly, I think there is the disadvantage that exists in any foreign corporation or distant corporation meeting the needs of a local small community, particularly, just as the Federal Reserve bank and the RFC are limited by that difficulty. I do not know that there is any reason why under Mr. Kaplan's plan you could get loans any more quickly than you could under 13B of the Federal Reserve or the RFC plan. However, I am not speaking against the plan. I think it would be somewhat difficult to build up a volume of business under that plan because of its removal from the local scene.

Mr. Scoll. You are talking now about money for established concerns. You are not talking about venture capital, are you?

Mr. Bimson. I am talking about money for new or old concerns or going concerns. What many new concerns need is capital in addition to their own to get started, and I would say no restrictions should be made. Let the banker determine whether the risk is too great to make the loan.

Mr. Scoll. Do you not think that any insurance plan such as you proposed would be exceedingly sensitive to changes in the business cycle, that in the event of a severe break or a sharp drop in business in any locality the mortality of these loans would be very great?

Mr. BIMSON. Not so much a short, sharp break as a long, prolonged one. It would certainly have a great increase in the mortality of small business. That follows naturally with your up-and-down cycle.

Mr. SCOLL. So you might anticipate a larger loss ratio than you would under title I?

Mr. BIMSON. Yes, you might; and we provided for it, we think, by increasing the insurance premium. For instance, relating to that 1½ percent, it might interest you to know that the average loss of all Federal Reserve members banks for a 20-year period is about 0.8 percent. Mr. Gunderson, I believe, in his testimony before this committee said the average loss of the RFC was three-quarters of 1 percent. The loss on FHA title I is less than three-quarters of 1 percent. So it might be safe to say that 1½ would be an adequate rate. That is a guess. I would not know.

Mr. SCOLL. Your bank is currently making business loans?

Mr. BIMSON. That is right.

Mr. SCOLL. I take it there are types of business loans which your bank is asked to make which under existing circumstances it does not feel it can make?

Mr. BIMSON. That is correct.

Mr. SCOLL. As the result of the national bank regulations and inspections of the bank examiners, and so forth, but that you could make such loans if they were insured; is that right?

Mr. BIMSON. That is right.

Mr. SCOLL. That is really what it gets down to?

Mr. BIMSON. That is correct.

Mr. SCOLL. Now, I would like to ask you one more question. You have indicated and other witnesses here have advocated some tax relief in various forms in addition to the accelerated depreciation. How do you propose to make up for the loss in revenue?

Mr. BIMSON. I do not know what that loss revenue would be, and I would not know how to make it up.

Mr. SCOLL. Let me give you a figure. The Treasury Department has estimated that the revenue which would be lost to the Government by the adoption of the dividend credit plan of the CED, which is addressed to this difficulty that you refer to, would cost the Federal Government something in excess of a billion dollars in revenue. How would you make that up?

Mr. BIMSON. I would reduce the expenses of government by a billion dollars.

Mr. SCOLL. Now, let's assume that the expenses were reduced but that still was not enough to make up the difference. Where would you put the increased tax if you had to do so?

Mr. BIMSON. You are assuming a problem that would not be there if you assumed the answer to my first question to be correct. I do not know. I am not a student enough of it to know what you might do. You are assuming that the expenses of government are a fixed amount, which cannot be changed. I think perhaps the assumption is wrong.

Mr. SCOLL. That is not my assumption. I am saying if you make up the reduction in revenue by reduction in expense, and there is still a net loss in revenue because of these reforms, where would you advocate making it up? If you had to make it up, that is?

Mr. BIMSON. You might tax some presently tax-exempt institutions, for example. This is not a matter on which I am an expert.

Mr. AITKEN. Could I make an observation?

The CHAIRMAN. Certainly.

Mr. AITKEN. It seems to me that if this principle of accelerated depreciation were permitted, that it would encourage the purchase, the acquiring of new equipment, not only in small business but in larger business possibly, which would have a tendency to increase productivity and thereby increase revenue and thereby increase taxes.

Mr. HERTER. May I inject a question there? What would the effect be if instead of with one sweep of the pen all business is allowed to set their own rate of depreciation or with the limitations Professor Mace suggested, it would be applicable only to equipment owned within a 12-month period of the enactment of the law, and all equipment thereafter acquired? You then would have a gradual reduction in your revenues or probably it would not be a noticeable reduction.

Mr. STEWART. I do not think it would.

Mr. HERTER. I am merely wondering whether you had considered that.

Mr. STEWART. Why ask for a whole pie if you can get a fraction? I think from a practical point of view that would be the right idea. Increased business and efficient business will give you more tax money. You know that and we all know that. Now, of course, the Government was pumping a lot of money into industry during the war, and there were heavy taxes and renegotiation money recovered. The prosperous times in this country were when we had peak production and we had no trouble balancing budgets in times of peak production. You stimulate business and keep it stimulated and keep business pushing forward and give them the incentive to push forward, and your tax problem becomes less acute, with good Government management on their own operating costs. You should keep that within reason, too, but I think that they can carry their own government if they have a chance. They cannot do it without production, and they will get less able to as they are less able to produce competitive-wise in their own country and competitive-wise internationally. We have got our foreign market pretty well blocked off now, and if we could get our stuff down and sell over there and get some of their stuff over here and get some international trade going, I think that would help.

The CHAIRMAN. Mr. Milton, I wonder if you would like to make a contribution. We want to hear from all the bankers.

Mr. MILTON. I think, Senator, that things have been said that should have been said. I could answer one question Mr. Scoll asked of Mr. Bimson. He asked about need for equity capital. With small business it does not matter whether it is a loan or is stock. However, the average small-business man does not want anybody in his business. That is true if he built the business from the ground. If he sacrificed for years to build it up, he does not want to sell any of the ownership to anybody.

I think Mr. McCabe told you the other day that most of the need of small business for equity capital was a need for long-term loans. Any plan that provides a long-term loan or that can be paid back out of the portion of net profit will satisfy, I should say, 90 to 95 percent of all demands of small business for capital.

Regarding this tax situation, if you let me say one thing, of course banks are small business. We wish we were big business in comparison to our customers, but very often our customers are many times larger than we are.

I happen to be president of a bank which is small business. We have about 4½ million dollars, about 10,000 customers. So you see, we deal with what you call small-business men and not with anything else. And if anybody knows anything about his problems, I expect we know it from the grass roots, because our staff is so small we deal with everybody and know what they are thinking about.

The CHAIRMAN. Mr. Milton, are you not a competitor of Coca-Cola?

Mr. MILTON. We are a competitor to everybody. In the banking business there are no brothers and sisters, no mothers and fathers. You do not pay any attention to anybody. You get what you can.

The CHAIRMAN. It would seem to me that in a memorandum which came up here from the Department of Commerce you were described as one of the promoters of a new soft drink or a very successful soft drink down there.

Mr. MILTON. We have several industries and we have had to finance some out of our own pockets. So far as that is concerned, we are a competitor in that respect, but I will not talk about that bottling company.

The CHAIRMAN. That was a great opportunity to put in a plug.

Mr. MILTON. I would like to talk about this tax business in my bank, if you will let me. You talk about how real this matter of this clutch bracket is. All right. We are in the clutch bracket. We have got $200,000 in capital on which to pay a dividend every year. If you do not pay them a dividend and then if we need new capital, we cannot get it.

If we grow, the Federal is going to be telling us, "Put some more capital in that thing. You boys do not have enough capital for the size concern you have."

We turn up with earnings of slightly over $25,000, we will say, and you come along and take a lot of that. You take your clutch back away from us and do not leave enough to pay dividends and put up reserves. We cannot sell stock because we do not have any net earnings to show people, and that is a very real problem. Since my bank is a 4½-million-dollar bank, it is a small institution, dont forget that, and that is the mid-most size bank in the Federal Reserve System. That is midway between the smallest-size bank and the largest-size bank in the System. I am talking about the problem of the middlemost bank in the United States—those in the South, and when you go to the West, of course, you find plenty of them after you start going west from Chicago.

Now, if we made $50,000, we would have the same problem. That is, between 25 and 50 thousand we would have the same problem. We simply cannot put up any capital to save our lives, cannot protect ourselves against losses in future years, and you and I know we put up our losses in good times and we take them in bad times. If the tax laws are such that we have to pay out our earnings in good years, we have no reserves to fall back on in bad times.

I do know that the tax laws as they stand today are particularly burdensome in that clutch bracket to the average banking institution like mine. I would like to say one more thing.

I am for this guarantee of funds. I think what has not been emphasized is this: That no banker in his right mind is going to make a capital loan simply to make interest. Four and one-half percent is not enough.

Mr. Bimson did not tell you that, but the truth of it is that no banker wants to take a long-term risk at 4½ percent. We are kicking on making GI loans, even though they are guaranteed, at 4 percent. I tried the other day to get a short-term loan in Atlanta and was told that a short-term loan would cost 4½ percent, even though it was secured. I know one bank was quoting 4½ percent. What bank is going to take a long-term capital risk at 4½ percent? You do not have to worry about the excessive losses in the long-term capital loans, because the banker will not take them. He is the first person to say whether or not business can pay a long-term capital loan.

The CHAIRMAN. Thank you, sir. Mr. White?

Mr. WHITE. On this question that was mentioned earlier, Senator, about why they do not invest in small business, we investigated some wholesale men in the oil business—one in eastern Massachusetts and another in western New York and another in central Pennsylvania. We said to them, "Why don't you sell stock?" And they said, "The Government doesn't want us to." We said, "Who told you that?" They would say, "Well, the Securities and Exchange Commission." We would say, "No, they don't mean that. Why don't you talk to them?" "Well, we can't go to Washington." "Well, there is one nearer than that." And so on, and so forth.

In a few minutes it became apparent that the Securities and Exchange Commission has almost served as a prohibition on the investment or on the offering for sale and the purchase of common stock in small business. I do not think the Securities and Exchange Commission intends that, but we do feel that there is need of education as to what they can and cannot do under the Securities and Exchange Commission regulations. I think in looking for the reason why there has been a lessening of equity capital coming forth for small business, that is one of the prime factors.

The CHAIRMAN. I wish you would amplify this impression that you have found that the SEC does not want to permit the floating of stock. What gives rise to that impression?

Mr. WHITE. I do not know. I was quite surprised at one or two cases and followed it through. I talked to the nearest Securities and Exchange office and told them what the man had said, and they said, "Why, that isn't so. He can sell stock up to the amount of $300,000 as long as it is an intrastate matter," but he did not know it. He did not know there were branches. It was a question of lack of information, but the impression is that the Securities and Exchange Commission does not want stock sold.

The CHAIRMAN. Now, have you yourself found that to be the impression?

Mr. WHITE. That is an impression among small-business men. Yes, I have talked to several of them.

The CHAIRMAN. I would like to know how many of the members of the advisory counsel entertains a similar impression.

Mr. WEAVER. In our own case I can throw some light on that. It is a question, I believe, as Mr. White says, of a lack of real knowledge of the ramifications of the Securities and Exchange rulings. We considered selling some stock to raise funds. We went first to a speculator, a brokerage house, and it was not interesting to them; so the only alternative—and I think this is where the catch comes—is to sell it privately. Then a lawyer, and so forth, will normally say, as they did in our case, "If you go beyond a certain number of people holding the shares, you come under this long list of regulations and problems," and the small-business man, as in many other things, just shies away because he becomes then in a bracket of Government supervision, you might say, that he does not understand.

The CHAIRMAN. How much money does the small-business man on the average require at a particular time for additional capital?

Mr. WEAVER. I think that is pretty near impossible to answer really because each case, of course, is different.

The CHAIRMAN. Let's consider the definition of small business as given by Mr. Kelly.

Mr. BIMSON. I think we would all be surprised if we knew how small the requirement of the average small business is. For instance, the California Bankers Association a few years ago tried to make a very complete survey of that by getting information from the banks as to small loan applications that had been made to them from businesses with a net worth of $100,000 or less, and they came up with a rather astonishing figure that the average amount was $4,800.

We have found in our own case in making spot checks of all the loans that we have made to businesses, the average gets down to a very low figure. I think what we are talking about more than anything else is the business that needs two thousand, four thousand, five thousand—small amounts.

The CHAIRMAN. That is precisely why I want to ask the question, since this has been raised by Mr. White: How in the world is it that any businessman who is intelligent enough to manage his own business can conceivably get the idea that the SEC is an obstacle to the sale of stock, either common or preferred, when the fact is that not even a prospectus is required for any issue less than $300,000?

Mr. WHITE. He does not know that.

Mr. BIMSON. Maybe we are talking about two different types of business.

The CHAIRMAN. Tell it to him.

Mr. WHITE. We will tell him.

The CHAIRMAN. If you told it to this particular individual with whom you were talking, were his fears not allayed?

Mr. WHITE. He felt a lot better.

Mr. HERTER. May I inject a comment there? I think Mr. White would have some difficulty in persuading him of that if he looked at the table on page 144 of the staff report prepared for this committee, showing that of the 71 flotations of under $1,000,000, that is between $300,000 and $1,000,000, it cost 17 percent to get the money; between one million and five million, 12½ percent; and then going down very rapidly until you got into the large flotations. Obviously, if the average for flotations of one million point one is 17 percent, a man trying to get equity money in excess of $300,000 but under $1,000,000 would pay an awful price for it. That is not all due to the SEC.

The CHAIRMAN. It is clear that that is not the problem of small business. We are talking now about an average of what?

Mr. BIMSON. That survey happened to show an average of $4,800 in California, and that is what we are chiefly talking about, I think.

The CHAIRMAN. Are there any other comments? Any other member of the group? Mr. Ford?

Mr. FORD. I might only cite one illustration a little bit out of the range of those already discussed, because the implications have been in the realm of rather small, very small, small business.

A manufacturing plant, which has grown slowly for many years, finally builds almost with their own hands a nice little plant in a Wisconsin town, has perhaps 50 people employed, and it finds its market changing. It has a good laboratory with new products coming through, but it needs a standstill period, let us say for illustration, of 3 years to develop those products and develop the market and freedom to go out and do the constructive job that it needs to do.

Let's say $50,000 is about what that plant might need. That is a little out of the range, but there are many, many manufacturing plants in that same situation, which require, as I have said, a standstill period for development in order to get going. I do not know that that has any particular point, but at least it illustrates quite a range, a number of industries in that size and range of 1,000,000 to 2,000,000 sales a year, to which those loans would apply. I have no other comments at the moment.

The CHAIRMAN. Are there any other questions? Any other statements by any member of the group?

Mr. Miller, this has been a most interesting session, and I am sure it has been beneficial to us on this side of the table. I note that there has been no discussion of the part that management plays in small business and its success. Have you any comment to make about that?

Mr. MILLER. Well, there is one thing that I would like to say just before that. That is that I think our committee is more interested and more sold on this type of financing for small business that has been suggested here than anything that the committee has ever become involved in. Their studies prove to them, they are sure, that some plan of that kind can be set up so it will finance 90 percent of small business without loss to anybody.

Now, taking up the matter of management, the matter of management certainly has a great deal to do with the ability of the small business to either secure capital or secure loans. If the local banker is the one who determines whether or not small business is entitled to a loan, the main thing that he will look at is not that security that you were talking about so much as the management of the business.

He is the only person who has the right to appraise that management and determine that that management can manage the loan that is given to him and make a success out of his business. The whole problem of small business is management, the same as it is in big business, as far as that is concerned.

I think you might be interested in the work that has been done by the Department in the matter of management. The Department is creating constantly a series of management booklets which are being sent out in tremendous quantities to small industry, taking into account every possible phase of management. We know, because of the demand made on the Department for the use of these pamphlets, that they are very, very well accepted by industry. Not only manufacturing but retail, and wholesale, and everything else. It is really one of the big jobs of the Department in our opinion, and we have worked a good deal along with the Department in connection with that. I do not know whether I have covered the point that you have in mind, Senator, with regard to management.

The CHAIRMAN. Well, I was interested only to develop whether or not there had been any special consideration given to that aspect of the problem, because, of course, it is an important thing.

Mr. MILLER. It is the important point.

Mr. FORD. May I make a comment, Senator?

The CHAIRMAN. Yes, Mr. Ford.

Mr. FORD. In the field of engineering, management engineering techniques are being developed to supplement the practical businessman's appraisal of the competence of management. In other words, instead of leaving it to, shall I say, off-the-cuff judgment, there are now techniques being developed for which the Association of Consulting Engineers is partially responsible for setting up evaluation factors that are so simple that an orderly analysis of management may be applied to the management factor, which is the important factor, I think, in the long run, and may be now appraised with a somewhat greater degree of accuracy than has been possible in the past.

The CHAIRMAN. Thank you, sir.

What is your program now, Mr. Miller?

Mr. MILLER. Tomorrow, we will consider the reports which will be made by our subcommittees, and then we will submit a report to the Secretary, which will include practically the report that we have made to you here today, and with the recommendation that our program with regard to the handling of loans to small business be actually put into practice.

The CHAIRMAN. If you desire to make any addition to your presentation here today, after your meeting tomorrow, the committee will be very glad to receive it. Now, is there any statement in conclusion that you, or any of your group, would like to make?

Mr. MACE. I was very much interested in your comment about management. Dr. Kaplan, in his CED book, Small Business, Its Place and Its Problems, termed management as the No. 1 problem of small business, and the more you look at small business, the more you are convinced it is true. It is a very fine study. I think it is a little dangerous to consider management assistance as a subsidy for small business, because I am afraid you are going to keep businesses in operation that do not deserve to be in business.

It seems to me you ought to maintain the right of businesses to enter into operation, but as soon as you start providing financial or other subsidy crutches to keep them from going broke, you are destroying an important part of our free enterprise system. I think it was the Assistant or Under Secretary of the Treasury who said one day: "I will defend unto death the right of a man to go broke." That is important.

The CHAIRMAN. You want to preserve the right of the owner of savings to go into business——

Mr. MACE. That is right.

The CHAIRMAN. At all hazards.

Mr. MACE. That is right.

The CHAIRMAN. The Government should assume that responsibility of keeping the door of opportunity open?

Mr. Mace. That is exactly right, sir, and there is one other thing, and that is that we in educational institutions, both Harvard, Michigan, Texas, Illinois, Indiana, and others, are trying to do something to open the eyes of our young men who are potentially competent managers of small business.

We think, and I personally sincerely think, that there is a tremendous need for competent management, and I think our young college-trained fellows do not realize the opportunity of running a business of their own. I get pretty excited about our security-minded youth, and I think those of us who are associated with giving small-business courses have a real job in trying to persuade them to consider the possibilities of going into a business of their own or working in small business as an alternative to, as one fellow put it, joining the civil service of big business.

I think there are opportunities in small business where these young college fellows in many cases have the potential capacity to become very able administrators of small organizations.

The Chairman. Mr. Hoffman, who until he became Administrator of ECA, was head of the CED, the Committee on Economic Development, and who was president of Studebaker, frequently used to say that the opportunity for the young man to go into business is there if the young man is willing to expend the energy and assume the risk of success and that the opportunity for success is real. I suppose you agree with that, do you not?

Mr. Mace. I certainly agree.

Mr. Miller. Senator, I would like to say that the committee appreciates being invited to come here. Practically our only contact, except such personal contacts as we might have, with Government is through the Department of Commerce. They are very nice to us, though, of course, they do not believe us all the time, and they do not accept all of our recommendations.

The Chairman. I assure you every member of the committee believes everything you said.

Mr. Miller. At any rate, we appreciate being asked, and if we can be of any service we will be glad to be.

The Chairman. Thank you very much, Mr. Miller. It has been, I think, a very beneficial afternoon.

The session is now adjourned.

(Whereupon, at 4:30 p. m., an adjournment was taken until 10 a. m., Wednesday, December 7, 1949.)

VOLUME AND STABILITY OF PRIVATE INVESTMENT

WEDNESDAY, DECEMBER 7, 1949

CONGRESS OF THE UNITED STATES,
JOINT COMMITTEE ON THE ECONOMIC REPORT,
SUBCOMMITTEE ON INVESTMENT,
Washington, D. C.

The subcommittee met, pursuant to adjournment, at 10:10 a. m., in the caucus room, Senate Office Building, Senator Joseph C. O'Mahoney (chairman) presiding.

Present: Senators O'Mahoney (chairman) and Taft.

Also present: David Scoll, special counsel to the committee.

The CHAIRMAN. The committee will come to order.

This morning we are to start the formal presentation of testimony with respect to the broad problem of the investment of savings.

I suppose it is only proper to say that on the degree to which privately owned savings are invested in trade and commerce and industry depends the extent to which what we call the free-enterprise system will continue to operate. We gather at a time when I think the great bulk of the people of the United States believe in the free-enterprise system, but everywhere else throughout the world we find appalling indications of an abandonment of that system. It is not too much to say that, unless we save it here in the United States, it may be lost for the world.

This is the background against which these hearings are being held. This committee has been charged by a resolution of Congress with undertaking to find out what can be found out about the facts of investment with the idea of making a report at the end of the year to the Congress for the consideration of the appropriate committees. We have asked numerous witnesses, who are thoroughly familiar with what is going on in the investment world, to appear before the committee and share with us their knowledge and understanding of the problem as they see it. The members of the staff of the committee, headed by Mr. David Scoll, who is special counsel for this purpose, have been in conference with those who have been asked to testify, and I think there is a pretty general understanding between the staff and the witnesses of the scope of the testimony. That means, of course, only that there has been a thorough examination of the groundwork. The purpose is to reveal everything that can be revealed about the problem.

Mr. Lincoln, president of the Metropolitan Life Insurance Co., is our first witness this morning. We have had him at this table before; and, as I glance around at the colleagues and associates who accompany Mr. Lincoln, my mind goes back to 1938 or 1939, when we were conducting the TNEC study of life insurance.

Mr. Lincoln, we are always glad to have you with us. The understanding is that you will present your prepared statement and that Mr. Scoll and members of the committee will question you from time to time. But you will be permitted to present your statement in full before any questions are asked, if that is agreeable.

STATEMENT OF LEROY A. LINCOLN, PRESIDENT, ACCOMPANIED BY FREDERICK W. ECKER, FINANCIAL VICE PRESIDENT, HARRY C. HAGERTY, VICE PRESIDENT AND TREASURER, AND ARNOLD LA FORCE, ASSISTANT VICE PRESIDENT, METROPOLITAN LIFE INSURANCE CO.

Mr. LINCOLN. Senator, I cannot resist observing, when you say you recognize so many of the associates here, that I see no one at your end of the table except yourself with whom we were familiar when we were here before.

The CHAIRMAN. Well, you see, Mr. Lincoln, that indicates to me the great hazards of political life and the security of life in big industry. [Laughter.]

Mr. LINCOLN. I think you have approached this thing in a most unique way—and I have been criticized sometimes for saying "most unique," because there is no such phrase—in a unique way, by having counsel sit down with those who are expected to produce some information on the subject and go over the proposed questions.

We have been favored with questions, and my embarrassment is that we have been favored with about three different sets, and I had carefully prepared answers and have had them duly allocated to my sheets in connection with the first questions as they appeared in the booklet. Then Mr. Scoll was good enough to send me some supplemental questions. I have another set dealing with the supplemental questions. Only a day or two ago I received a third set, and I have the answers to those here. And, if I am a little bit confused in fumbling through my papers, I hope you will be charitable with me.

Last night these fellows—I was not here; I was in New York—put together a fourth set, pasted together, so I am going to be considerably embarrassed.

Senator TAFT. I have not been in on this, so there may be a fifth set.

The CHAIRMAN. Whether there are four or five, I am frank to say for the record that, if you are either embarrassed or confused today, it will be the first time that you have exhibited any such aspect in this committee room.

Mr. LINCOLN. I live in a constant state of confusion. I did want to say for the stenographer that my associates here, who are much better versed in these financial questions than I am, are Mr. Frederick W. Ecker, financial vice president of the company; Mr. Harry C. Hagerty, vice president and treasurer; and I had understood from the counsel or the secretary of your committee that we may more or less interpolate our answers as the occasion arises.

The CHAIRMAN. Yes; of course.

Mr. LINCOLN. You say I should read the statement. This has been prepared at the request of counsel and may be a little long, but it may be a good introduction if I am to spend the morning here.

The CHAIRMAN. You may proceed.

Mr. LINCOLN. We have been requested to furnish a summarization of the detailed answers which have been prepared in response to a questionnaire and a supplemental questionnaire furnished to prospective witnesses before the subcommittee. This summarization will not necessarily follow in exact consecutive form the various questions and supplemental questions contained in such questionnaire.

The replies to the questions serve to bring out the views of the Metropolitan Life Insurance Co. with respect to institutional investors and the part they play in financing our economy.

Under the law of New York, where the Metropolitan is incorporated, the insurance department is required to make an examination of each company within its jurisdiction every 3 years. This examination is participated in by representatives of other State insurance departments and is so thorough that in our own case it takes about 1½ years to complete.

As a consequence, it may be said that the examiners of the insurance department are living with us for approximately 50 percent of the time. Besides the triennial examinations, the New York department is in constant daily touch with the company to secure information or to explore any question which it may desire to investigate.

In response to the first question in the questionnaire, we would say that, if existing restrictions on qualified investments were entirely eliminated, the policy of the company as to allocation of different types of investment in its portfolio would not be materially changed on that account. Such policies are never static.

There is no fixed minimum amount below which the company would be unwilling to go in making a particular investment, nor is there a maximum amount, so far as concerns company policy, although there are, of course, certain statutory maxima which apply to the company's investments in certain fields.

The company's funds are available for suitable investments, large or small.

We believe in the necessity for diversification, and a series of exhibits will be submitted indicating how completely this policy of diversification has been carried out. Our company holds investments in every State of the Union, plus the District of Columbia (to sav nothing of those held in Canada). We have 107 city-mortgage loan correspondents, thus affording Nation-wide coverage for this type of lending, and there are also some 16 farm-loan branch officer and correspondents covering farming areas. Our investments are diversified in well over 100,000 separate instances throughout the Nation.

Exhibit 1 indicates the company's investments in the United States segregated by area. In this connection, it is interesting to note that in all areas, with the exception of New England, Middle Atlantic and East North Central, our investments exceed our reserves. It is well known that the Eastern States are lending States and the Western and Southern are borrowing States.

Stated in another way, funds tend to flow from those areas having a surplus to those where the demand exceeds the supply. The exhibit just submitted demonstrates this fact with regard to our own company and shows very clearly that it is only the New England and Middle Atlantic States—that is to say, from Pennsylvania to

Maine—where our investments are materially less than the reserve on business in force.

Exhibits 2 to 7, inclusive, are responsive to specific questions in counsel's supplemental questionnaire, and indicate the diversification of our investments on both a geographical and a functional basis. They indicate how thoroughly life-insurance funds tend to support all segments of our economy. We have no hard and fast rules as to what constitutes either the minimum or the maximum investment we will make.

The minimum is best illustrated in exhibit 6 by the fact that we have over 39,000 separate loans in the city-mortgage and farm-mortgage fields in amounts less than $5,000 each. In the securities field as of December 31, 1948, we held 131 bond and stock investments under $500,000, and 107 more between $500,000 and $1,000,000.

The typical small loans in this field have ranged from the financing of independent telephone companies to various segments of industry, such as, small iron and steel, food, building material, department store, and textile companies.

If there is, as some assert, a shortage of equity capital, it is our opinion that any apparent shortage of this kind is attributable to the lack of incentives for investment in common stocks on the part of the general public. A fallacious view is held by some people to the effect that savings are being channeled to an increasing degree through life-insurance companies, thus diminishing the supply of "equity capital," as such. Statistics and tabulations, as witness certain sections of the publication entitled "Factors Affecting Volume and Stability of Private Investment," set forth quite a contrary conclusion.

The bulk of our investments is of the fixed-interest-bearing type. This has raised a question as to whether the continued investment by life-insurance companies in debt obligations has weakened the structure of our economy, and whether as a result there is a shortage of "equity capital." This thesis is not borne out by the facts.

The growth of the life-insurance business has only been in line with the growth of the economy as a whole. One measure of this is the relationship between the gross premium income of the life-insurance business and individuals' net disposable income (that is, net income after taxes). The proportion going into life insurance is not only small but it is even smaller than it was 20 years ago. In 1929 this percentage was 4.1 percent, whereas in 1948 it was 3½ percent.

When one deducts the return payments by life-insurance companies, such as death benefits, annuities, dividends, et cetera, the proportion is cut in half—namely, to 1.7 percent. It is also true that, notwithstanding the steady growth of business over many years, the face amount of insurance in force in all companies is today no more than approximately 1 year's personal income.

Senator TAFT. Personal income of all the people in the United States?

Mr. LINCOLN. As I understand the figures; yes, sir.

Mr. ECKER. Yes, sir.

Mr. LINCOLN. It seems to be pretty generally conceded, outside some Government circles, that both the buying and the selling and the holding of stocks are inhibited by high individual income taxes, the capital-gains tax, and the unsound provision for double taxation of dividends. Furthermore, high inheritance and estate taxes also discourage the holding of common stocks.

Finally, on this subject, cumulative evidences of desire on the part of the Government to widen business controls and to create new forms of governmental competition with private business would, of themselves, discourage investment in business equities.

As relates to debt securities, which are the principal type of investment available for life-insurance companies, the requirement for sound investment indicates different percentages of overlying equities, according to the type of business and prospective earning power. There is no general trend toward modification of the equity requirements but there have, of course, been substantial reductions in long-term private debt obligations which accompanied both the depression and the war, and which were followed by impressive increases thereafter since the war.

In the last analysis, the matter of financing of enterprise by way of creation of debt or creation of equity capital becomes a matter of policy with the respective businesses. The joint committee print, on page 80, discusses this subject under the heading "Corporate debt is not unduly large."

There has been no scarcity of corporate bond flotations for new capital which, on the contrary, have been materially increased since the war and appear to have been more than adequate for the needs of investors. The important figure is the amount of bond issues for new capital and this has increased materially in the postwar period.

In the last 3 years life-insurance companies have had occasion to dispose of approximately $6,000,000,000 of United States Government obligations in order to supply the capital needs of industry and the demand for mortgage money. This would seem to be ample evidence that the supply of such investments substantially exceeds the current income available.

There has been much discussion in various quarters as to so-called private placements of securities acquired by life-insurance companies. The fact is that such private placements are initiated typically by the borrowers either directly or through an intermediary acting as an agent for the borrower.

In the case of the Metropolitan, it has never in a single instance initiated such negotiations. So-called private placements represent a simple, direct method of financing. In no situation of which I have knowledge does the lender attempt to supervise or control the operations of the borrower.

The indenture provisions are intended to set broad limits to prevent the financial weakening of the corporation and thus the weakening of the position of the borrower; but beyond this no attempt is made to dictate management policies or decisions.

As requested, there is submitted exhibit 8 which sets forth the corporate purchases made in 1948, segregated by means of acquisition. It is interesting to note that the largest category is loans brought to us through an intermediary, usually an investment banker acting as agent for the borrower. Of the 518 direct security purchases which we made between 1934 and 1948, 271, representing approximately 50 percent in amount, were brought to us in this manner. There is also submitted exhibit 9 setting forth the purposes for which such loans were made last year.

These private placements are valued for insurance department purposes under regulations which require that they be carried at amortized value under certain circumstances and, where there are no publicly reported market values, then through a determination by a bureau set up by State insurance departments.

Responding to one of the questions, the Metropolitan does not invest in common stocks, which type of investment is forbidden by the New York insurance law.

The Metropolitan has certain direct real-estate investments permitted under the New York insurance law but in amounts nowhere approaching these permissible as related to the company's assets. Incidentally, such direct investments are carried at cost less annual depreciation or amortization, as required by the New York insurance law, under a special provision for periodically writing down the valuation of commercial real estate.

To sum up the whole situation, funds flow into the life-insurance treasury at a relatively steady rate. It is our objective to keep such funds invested as promptly as possible. The steady employment of funds has tended in the past to provide a fair average rate of return over a long period of time coincident with the period for which our life-insurance policies are outstanding. The easy money policy of recent years has had the unfortunate effect of reducing materially the earning power of such funds held for policyholders and, consequently, increasing the net cost of their insurance.

The question has been raised as to whether the pressure on life-insurance companies to find investment outlets and the consequent demand for fixed interest-bearing obligations may be responsible for the present low level of interest rates. In a free economy the total supply of funds relative to the total demand determines interest rates.

Certainly savings effected through life insurance represent one of the factors on the supply side of the picture but only one. Funds are also supplied by both commercial and savings banks, building and loan associations, pension funds, both private and governmental, by Government-owned corporations, farm credit agencies, corporations through retained earnings, as well as by direct savings of individuals.

On the demand side, all forms of demand for money tend to play their part, whether the demand be represented by the sale of stock, short-term obligations or long-term debt. It is the interplay of many factors which determines interest rates.

If any extraneous factor is brought into play, such as legislative and governmental action, the result is an impact on the economy, which it is for this committee to evaluate.

The questionnaire poses certain questions as to the part to be played by business, by financial institutions, or by government in investment matters. It is our opinion that business has the following responsibilities:

1. To provide steady employment at a fair wage.
2. To progress through planned modernization, research, and improvement.
3. To lower the selling price of product and to widen markets.
4. To distribute fairly among consumers, employees, and stockholders the financial gains of such business.

Financial institutions have a responsibility to study and follow the possibilities for new investment outlets and the Government, on its part, should foster an economic climate in which private business can operate with confidence. Every effort should be made to reduce Government expenditures, and taxes should be reduced and not increased.

This imposes, in our view, the heaviest possible responsibility on the part of our lawmakers to provide greater incentive to risk-takers and a sound background for investment by the public and by lending institutions. Surely, while antitrust laws should be supported and monopolies forbidden, the great responsibility of government lies in the specific necessity for developing and fostering an improved business atmosphere.

That, sir, was our effort to satisfy the request of counsel that we try to summarize the answers to dozens of questions which were propounded.

(The exhibits referred to follow:)

EXHIBIT I.—*Metropolitan Life Insurance Co.—Estimated reserves and total ledger assets in the United States, Dec. 31, 1948*

States	Estimated reserves	Percent reserve to total United States	Total ledger assets excluding U. S. Governments	Percent ledger assets to total United States	Ledger assets including U. S. Governments per capita basis July 1948 census	Percent ledger assets including U. S. Governments to total United States	Percent ledger assets including U. S. Governments to estimated reserves
New England	$871, 150, 210	11. 19	$210, 018, 415	4. 32	$409, 956, 742	5. 13	47
Middle Atlantic	3, 165, 515, 162	40. 65	1, 861, 503, 093	38. 28	2, 500, 490, 943	31. 26	79
East North Central	1, 615, 510, 632	20. 75	884, 984, 240	18. 21	1, 525, 852, 386	19. 08	94
West North Central	472, 149, 325	6. 06	368, 851, 659	7. 58	668, 445, 765	8. 36	142
South Atlantic	666, 992, 987	8. 57	466, 457, 289	9. 59	883, 570, 004	11. 05	132
East South Central	227, 756, 087	2. 93	239, 537, 714	4. 92	474, 261, 550	5. 93	208
West South Central	176, 549, 235	2. 27	349, 218, 324	7. 17	651, 632, 877	8. 15	369
Mountain	93, 679, 074	1. 20	99, 422, 025	2. 04	196, 257, 359	2. 45	209
Pacific	496, 968, 764	6. 38	383, 809, 301	7. 89	687, 164, 003	8. 59	138
Total, United States	7, 786, 271, 476	100. 00	4, 863, 802, 060	100. 00	7, 997, 631, 629	100. 00	103
Investments not geographically distributed less gross decrease by adjustment	--------	--------	377, 293, 311	--------	377, 293, 311	--------	--------
Territories	633, 712	--------	485, 840	--------	485, 840	--------	--------
Total	7, 786, 905, 188	--------	5, 241, 581, 211	--------	8, 375, 410, 780	--------	--------

EXHIBIT II.—*Metropolitan Life Insurance Co.—Investments in United States Dec. 31, 1948—Bonds, stocks, mortgages, and real estate held for investment, including foreclosures*

[In thousands of dollars]

1. Manufacturing	1, 060, 308
2. Trade	241, 281
3. Electricity, gas, water, and telephones	917, 748
4. Railroads	572, 831
5. Other transportation	221, 775
6. Single-family residential real-estate mortgages	449, 782
7. Multifamily residential real-estate mortgages	405, 011
8. Multifamily real-estate direct investments (housing)	255, 392
9. Mortgages on commercial real estate held for rental purposes, such as office buildings, garages, loft buildings, hotels, and so forth	284, 885

EXHIBIT II.—*Metropolitan Life Insurance Co.—Investments in United States Dec. 31, 1948—Bonds, stocks, mortgages, and real estate held for investment, including foreclosures*—Continued

9a.	Real estate owned through foreclosure	45,980
	Real estate held for investment	13,628
10.	Mining, including oil and gas	310,284
11.	U. S. Government securities	3,133,357
12.	Securities issued by public authorities other than the U. S. Government, including State, county, and municipal governments, segregated if possible according to purpose, such as schools, hospitals, sewage plants, and other municipal services	6,810
	Total, United States	7,919,072

NOTE.—These figures include only United States corporate bonds, stocks, city and farm mortgage loans and real estate held as an investment, including housing and foreclosed real estate. Bonds have been included at par value, stocks at cost, and motgages and real estate at book value. The major assets which are not included were our policy loans, cash, real property for company use, all Canadian investments, and miscellaneous and nonledger assets. Because of the limited number of classifications, many of our corporate bond holdings had to be classified under "manufacturing." We, therefore, classified everything under manufacturing which we did not feel fell under trade or the other specific classifications.

No. 4. Railroads include general American transportation equipments.

No. 5. Other transportation includes air lines, tankers, and all pipe lines.

No. 8. Multifamily real estate direct investment is our total housing investment, including Stuyvesant Town and Riverton bonds and stocks.

No. 9. Includes bond issues secured only on commercial real estate such as Rockefeller Center and Park and Forty-sixth Street, etc.

No. 12. Includes Chicago Transit Authority and the International Bank.

EXHIBIT III.—*Metropolitan Life Insurance Co.—Geographical distribution of corporate bonds, stocks, and mortgages in the United States*

States	Held Dec. 31, 1948	Acquired during year 1948	States	Held Dec. 31, 1948	Acquired during year 1948
Alabama	$57,103,012	$12,279,593	North Carolina	67,342,780	13,783,368
Arizona	19,545,400	7,259,788	North Dakota	7,281,543	709,800
Arkansas	25,702,985	8,707,162	Ohio	243,613,612	38,847,423
California	243,908,154	68,559,652	Oklahoma	59,251,642	18,491,909
Colorado	13,943,353	1.494,715	Oregon	16,751,075	2,360,564
Connecticut	34,453,816	6,337,434	Pennsylvania	345,240,115	67,223,778
Delaware	5,440,050	16,800	Rhode Island	19,181,078	7,912,561
District of Columbia	35,558,801	7,482,794	South Carolina	28,564,897	6,902,224
			South Dakota	9,784,879	1,018,850
Florida	38,935,304	10,598,921	Tennessee	71,541,686	28,925,245
Georgia	58,214,481	14,453,368	Texas	195,206,777	76,296,888
Idaho	8,154,905	723,300	Utah	10,319,953	4,486,385
Illinois	215,156,152	32,571,216	Vermont	6,767,134	920,450
Indiana	148,670,856	34,107,084	Virginia	57,616,172	10,165,662
Iowa	75,022,178	26,105,943	Washington	58,294,594	18,259,493
Kansas	87,853,933	29,556,610	West Virginia	56,743,382	5,556,173
Kentucky	72,095,738	10,799,488	Wisconsin	36,567,970	10,094,239
Louisiana	61,427,070	24,242,756	Wyoming	4,783,700	61,800
Maine	5,162,635	794,400			
Maryland	65,426,729	24,128,340	Total, United States	4,031,115,033	863,829,938
Massachusetts	90,392,226	17,624,036			
Michigan	147,389,824	17,757,844	Investments not geographically distributed	388,014,784	248,331,900
Minnesota	46,736,662	11,815,186			
Mississippi	25,618,519	9,588,663			
Missouri	89,439,375	28,333,846	Territories	472,468	------------
Montana	12,528.505	48,400			
Nebraska	20,436,289	5,026,340	Total corporate bonds, stocks, and mortgages	4,419,602,285	1,112,161,838
Nevada	5,362,046	242,650			
New Hampshire	10,915,172	964,300			
New Jersey	148,009,122	26,093,826			
New Mexico	19,528,157	7.726,497			
New York	848,130,595	106,372.174			

EXHIBIT IV.—*Metropolitan Life Insurance Co.—Corporate bonds, stocks, city mortgage, and farm-mortgage investments in United States—Number and size of invested units*

OWNED DEC. 31, 1948

	Bonds and stocks		City mortgages		Farm mortgages		Total	
	Number	Amount	Number	Amount	Number	Amount	Number	Amount
Under $5,000	-----	-----	32, 315	$80, 005, 000	6, 866	$18, 532, 000	39, 181	$98, 537, 000
$5,001 to $15,000	-----	-----	40, 212	310, 342, 000	5, 977	49, 543, 000	46, 189	359, 885, 000
$15,001 to $35,000	5	$134, 000	1, 545	34, 626, 000	1, 011	20, 250, 000	2, 561	55, 010, 000
$35,001 to $100,000	19	1, 309, 000	1, 253	78, 773, 000	109	5, 056, 000	1, 381	85, 138, 000
$100,001 to $500,000	105	32, 875, 000	1, 111	220, 399, 000	4	556, 000	1, 200	253, 830, 000
$500,001 to $1,000,000	107	85, 744, 000	126	88, 321, 000	-----	-----	233	174, 065, 000
$1,000,001 to $5,000,000	313	855, 424, 000	94	182, 457, 000	-----	-----	407	1, 037, 881, 000
$5,000,001 to $10,000,000	87	667, 804, 000	3	17, 263, 000	-----	-----	90	685, 067, 000
$10,000,001 to $25,000,000	48	712, 631, 000	1	20, 025, 000	-----	-----	49	732, 656, 000
Over $25,000,000	23	986, 180, 000	-----	-----	-----	-----	23	986, 180, 000
Total	707	3, 342, 101, 000	76, 660	1, 032, 211, 000	13, 967	93, 937, 000	91, 334	4, 468, 249, 000
ACQUIRED DURING 1948								
Under $5,000	-----	-----	7, 750	$20, 521, 000	681	$2, 237, 000	8, 431	$22, 758, 000
$5,001 to $15,000	-----	-----	23, 268	185, 234, 000	1, 636	14, 087, 000	24, 904	199, 321, 000
$15,001 to $35,000	1	$29, 000	545	10, 193, 000	448	8, 832, 000	994	19, 054, 000
$35,001 to $100,000	-----	-----	168	10, 816, 000	47	2, 096, 000	215	12, 912, 000
$100,001 to $500,000	11	2, 936, 000	153	29, 431, 000	1	110, 000	165	32, 477, 000
$500,001 to $1,000,000	11	10, 287, 000	7	4, 193, 000	-----	-----	18	14, 480, 000
$1,000,001 to $5,000,000	51	156, 833, 000	3	5, 850, 000	-----	-----	54	162, 683, 000
$5,000,001 to $10,000,000	23	183, 773, 000	-----	-----	-----	-----	23	183, 773, 000
$10,000,001 to $25,000,000	10	146, 516, 000	-----	-----	-----	-----	10	146, 516, 000
Over $25,000,000	5	317, 000, 000	-----	-----	-----	-----	5	317, 000, 000
Total	112	817, 374, 000	31, 894	266, 238, 000	2, 813	27, 362, 000	34, 819	1, 110, 974, 000

EXHIBIT V.—*Metropolitan Life Insurance Co.—Corporate bond and stock investments in United States companies, by products and services*

[In thousands of dollars]

	Held Dec. 31, 1948	1948 purchases		Held Dec. 31, 1948	1948 purchases
1. Agricultural equipment	12, 843	10, 000	14. Metal products	26, 546	1, 000
2. Amusements	21, 912	-----	15. Nonferrous metals	104, 258	55, 000
3. Automobiles and equipment	51, 844	-----	16. Office equipment	22, 524	7, 000
4. Transportation	778, 128	96, 711	17. Pulp and paper	42, 819	15, 900
5. Building material and equipment	39, 814	19, 000	18. Oil and coal	288, 602	189, 700
6. Chemical	202, 866	32, 500	19. Real estate	12, 608	6, 263
7. Electrical equipment	58, 373	6, 000	20. Retail distribution	103, 452	35, 775
8. Finance	117, 310	94, 000	21. Rubber	87, 211	9, 000
9. Food and drug	84, 983	30, 250	22. Shipping	42, 079	45, 130
10. Glass and optical	16, 000	8, 000	23. Steel and iron	121, 468	7, 485
11. Heavy machinery and equipment	11, 372	2, 700	24. Textile	46, 320	31, 750
12. Household products and equipment	9, 577	-----	25. Tobacco	75, 53	8, 000
13. Meat packing	34, 142	20, 000	26. Miscellaneous	12, 703	1, 500
			27. Public utilities	917, 748	84, 710
			Total	3, 343, 069	817, 374

EXHIBIT VI.—*Metropolitan Life Insurance Co.—Corporate bonds, city mortgages and farm mortgages investments in United States—Interest rates*

Interest rates	Total owned Dec. 31, 1948	Total acquired 1948
2 percent and under	$6,374,000.00	----------
2.01 to 2.5 percent	56,436,000.00	----------
2.51 to 2.75 percent	791,054,000.00	$11,200,000.00
2.76 to 3 percent	975,130,386.84	262,232,830.59
3.01 to 3.25 percent	447,811,147.75	163,384,252.64
3.26 to 3.50 percent	681,658,585.02	259,040,997.98
3.51 to 3.75 percent	177,912,359.57	114,875,276.44
3.76 to 4 percent	788,623,878.72	257,763,517.22
4.01 to 4.25 percent	36,530,069.26	8,109,784.24
4.26 to 4.50 percent	254,728,222.26	19,330,128.18
4.51 to 4.75 percent	18,004,540.90	7,611,260.00
4.76 to 5 percent	117,193,124.42	172,590.00
5.01 ot 5.25 percent	151,026.49	----------
5.26 to 5.50 percent	5,193,625.81	38,614.34
5.51 to 5.75 percent	4,577.47	----------
5.76 to 6 percent	4,023,739.00	----------
Total	4,360,829,283.51	1,103,759,251.63

EXHIBIT VII.—*Metropolitan Life Insurance Co.—Form of investment contract*

[In thousands of dollars]

	Total held Dec. 31, 1948	Total acquired during 1948
(*a*) Purchase and lease backs	$13,628	$5,587
(*b*) Mortgage bonds and city and farm mortgages	2,706,214	564,048
(*c*) Debentures	1,644,254	533,906
(*d*) Convertible bonds	10,805	5,805
(*e*) Preferred stock	101,482	7,214
(*f*) Common stock	5,495	0
Total	4,481,878	1,116,560

EXHIBIT VIII.—*Metropolitan Life Insurance Co.—1948 purchases of bonds and stocks (railroads, public utilities, and industrial)*

	Bonds (par)	Stocks (cost)	Total
1. At the instance of the borrower	$321,863,000	----------	$321,863,000
2. Through an intermediary generally acting as agent for the borrower	438,084,920	$225,000	438,309,920
3. Through purchase of public offerings	50,211,700	6,989,359	57,201,059
Total	810,159,620	7,214,359	817,373,979

EXHIBIT IX.—*Metropolitan Life Insurance Co.—Metropolitan's 1948 purchases of direct loans, bonds, and stocks*

Purpose of Loan:

Refunding bank loans	$221,275,000
Refunding existing securities	19,563,000
Additional working capital	155,950,000
Plant expansion	363,384,920
Total	760,172,920

NOTE.—Such classifications must of necessity be arbitrary and there must be considerable overlapping. For example, some of the loans classified as for "additional working capital" no doubt were required because working capital had been depleted as a result of plant expansion.

The CHAIRMAN. Mr. Scoll?

Mr. SCOLL. Do you have any further comments, Mr. Lincoln, to add to your set of statistical exhibits?

Mr. LINCOLN. Well, it is pretty difficult to define them detail by detail here.

Mr. SCOLL. Let me ask you a question or two. Would you take exhibit No: II? That shows that in terms of the amount of the assets in Metropolitan slightly more than a billion dollars is invested in manufacturing. Next to Governments, that seems to be your biggest field of investment. Now, does that represent a recent policy of Metropolitan or has Metropolitan always been a large investor in manufacturing enterprises?

Mr. LINCOLN. I should say it was probably fairly recent. We have gone in for investments in industry more in the last few years than in earlier history.

Mr. SCOLL. Now, you show a relatively small amount compared to your total portfolio in railroads. Does that represent a decline in your investments in railroads, and do you still make investments in railroads?

Mr. LINCOLN. I think that currently these investment officials are investing in railroad securities, but probably not to the degree that was resorted to, say 20 years ago or more.

Mr. SCOLL. So that you would say as a field of investment the manufacturing has been on the way up in your evaluation?

Mr. LINCOLN. Industries generally—manufacturing and other types of industry.

Mr. SCOLL. And railroads on the way down?

Mr. LINCOLN. Well, I do not know as "the way down" is the way to express it, but more or less static.

Mr. SCOLL. They are not as interesting any more?

Mr. LINCOLN. Not so appealing. Is that a good way to put it?

Mr. SCOLL. That is an adequate way to put it. Now, what about farm mortgages?

Mr. LINCOLN. What about them?

Mr. SCOLL. Do you care to comment on your policy with respect to farm mortgages? Are you currently investing in farm mortgages?

Mr. LINCOLN. Very actively seeking them in areas suitable for farm investment.

Senator TAFT. Which classification do they come under?

Mr. LINCOLN. They ought to be earmarked there, sir.

Senator TAFT. There is nothing about farm mortgages.

Mr. SCOLL. They are shown on exhibit IV, Senator, in detail.

Mr. LINCOLN. I am afraid I am going to have to pin that back on counsel. I think those classifications were what he submitted to us.

Mr. SCOLL. They are shown in detail on exhibit No. IV.

Senator TAFT. Still I would like to know where they come on exhibit II. Are they under No. IX?

Mr. LINCOLN. Not in dollar amounts, at all. Counsel submitted this list here, and we filled it out in accordance with his categories, and I am sorry if he or we have missed farm mortgages as such.

The CHAIRMAN. But the 12 items on exhibit include everything, do they not?

Mr. LINCOLN. Where could farm mortgages be? I think Senator Taft has a point. Which is the category for farm mortgages?

Mr. SCOLL. I think they do not include farm mortgages, because the total amount of investments——

Mr. LINCOLN. My colleagues say farm mortgages are not in the list.

The CHAIRMAN. In any event, the total of farm mortgages is $93,937,00, as set forth in exhibit IV.

Mr. LINCOLN. As appears in one of the other exhibits. That, I may say, has passed the hundred million mark this year.

The CHAIRMAN. Of interest to me in that respect is that the bulk of your farm mortgages appears to have been classified in loans from $15,000 down. Am I reading that exhibit correctly?

Mr. LINCOLN. I am sure that is so.

The CHAIRMAN. Whereas, with respect to bonds and stocks, quite the reverse is true. With respect to farm mortgages, both in numbers and in amounts, the loans have been made to applicants for small amounts, whereas with respect to bonds and stocks the loans have been both in number and in bulk to applicants above $100,000.

Mr. LINCOLN. It could hardly be otherwise, because you find very few farms in that upper category.

The CHAIRMAN. I am not making an issue about it. I am just trying to confirm my understanding of the facts.

Mr. LINCOLN. It is definitely true. The farm mortgages are naturally on farm properties that are small in amount as related to these bond and stock issues.

The CHAIRMAN. Could it not be said this way: that the farm mortgages are issued to individuals——

Mr. LINCOLN. Yes.

The CHAIRMAN. And the business loans, on the other hand, are for the most part issued to corporate entities of one kind or another?

Mr. LINCOLN. I dare say for the most part, but not exclusively.

The CHAIRMAN. I would think not, but that is a question to which I might want to come a little bit later. One of the aspects of this study of investments involves the degree to which an individual businessman has access to institutional savings for his purposes. In other words to what extent does the small-business outfit, whether corporate, partnership, or individual—by "small business" perhaps we would take such a business as requires a loan of less than a hundred thousand dollars—have access to the large institutional savings?

Mr. LINCOLN. I may answer that we are looking for them but most investments of that sort find their outlet locally.

The CHAIRMAN. Yesterday the Small Business Advisory Council of the Department of Commerce was here and presented to us a very interesting representation of the conditions that exist in the small-business field. Their testimony was that the loans that are needed by small business are not presently available, and they have made several very interesting suggestions as to what Government policy should be to create a larger flow of loan capital to small business.

So I am merely trying to find out now what is your experience as a representative of a very large institutional investment management group with respect to the availability of such money for such purposes and what should be done.

Mr. LINCOLN. I tried to say and I will say again that we are anxious to get them, we are in the market for those investments, they are not too easy to locate, because they, in our experience, find their answer locally. We are anxious to get them.

The CHAIRMAN. The small-business people tell us they are not finding them locally.

Mr. LINCOLN. I would like to argue that with the small-business people rather than the chairman of this committee.

The CHAIRMAN. I am trying to find out the facts as you know them. I do not want to argue with you or anybody else about this. I want to find out what the situation is.

You say it is difficult to find them. What do you do to find them?

Mr. LINCOLN. We have, as stated in this statement I read, 107 correspondents scattered all over the United States, whose business it is in relation to us to locate investment oportunities for us in the city mortgage field, and we have these banking institutions which are depositors and have relationships with us, who all understand that we are seeking these investments; and if they cannot be satisfied locally, we would like them to report them to us.

The CHAIRMAN. Did you mean to limit that to the city mortgage field?

Mr. LINCOLN. No, sir. I said that the banks all over the country, with which we have banking relations—deposit or otherwise—their offices all know that we are in the market for these business loans.

The CHAIRMAN. Then you want it clearly understood throughout the United States where the Metropolitan operates that you are ready and willing to examine applications for business loans?

Mr. LINCOLN. If it is feasible.

The CHAIRMAN. Yes, of course.

Mr. LINCOLN. It is quite a point. If it is feasible for them to be handled in that way, we are in the market for them.

The CHAIRMAN. What constitutes feasibility?

Mr. LINCOLN. I am going to have to ask one of my colleagues to answer that, because they live with it and I would like to have one of them answer the question of feasibility.

The CHAIRMAN. Very well.

Senator TAFT. May I ask the question of the difference between manufacturing—you are talking about all small business?

The CHAIRMAN. Yes.

Senator TAFT. I suppose there is a distinction between manufacturing and commercial institutions.

The CHAIRMAN. Yes, there would be.

Mr. LINCOLN. I will put Mr. Ecker forward, for instance, to suggest to you what the situation would be which would enable us to make those loans.

Mr. ECKER. Well, Senator, we are presuming now that a borrower or at least a prospective borrower has been to his local bank and the local bank believes that the credit is a sound credit but that the loan is more than the local bank wants to loan or else the situation is that the borrowing is for a longer period of time than the local bank would care to lend.

Under those circumstances we would expect and we have had numerous instances where the bank would communicate with us. First by correspondence we endeavor to ascertain whether it looks as if this is a loan which would meet our requirements. Assuming it does, then we either send one of our people out to go over the property or else—well, in practically all cases we do that.

The CHAIRMAN. You speak of meeting your requirements.

Mr. Ecker. Yes, sir.

The Chairman. That is what I am trying to get at. What are your requirements?

Mr. Ecker. Our requirements are based on our estimate as to the ability of the borrower to meet the obligations that he undertakes. They have nothing to do with the size. The point I am trying to make is that if they want to borrow $50,000 or any other such figure, we stand ready to make the loan, but if they have just got a good idea and no record of experience in the field, we are not ready to use policyholders' funds in an enterprise of that nature.

Mr. Scoll. What debt-equity ratio would you require for, let us say, a manufacturing loan for a small company that is, we will say, manufacturing furniture and wants to borrow $50,000? What sort of debt-equity ratio would you require for a small company like that?

Mr. Ecker. Of course, there are no hard and fast rules. It is going to depend on the particular situation in each individual case. But giving you a very rough round figure as a rule of thumb, in the neighborhood of, say, 75 percent.

Senator Taft. What is that? Seventy-five percent of what?

Mr. Ecker. Of assets. In other words, a small industrial concern, which presumably has a fluctuating earning power over a period of time, we believe that in general their debt obligation that they should take on should not exced 25 percent of their assets.

Senator Taft. Twenty-five percent of assets.

Mr. Ecker. That, of course, will vary with the earning power that has been demonstrated and the type of security they have to offer.

Now, many of these smaller industrial loans can be satisfied by mortagage loan on real estate, so that you have the security of the real estate. In that instance you are looking almost entirely to the security of the real estate and under those circumstances the ratio would be higher.

Mr. Scoll. We are talking about unsecured loans now.

Mr. Ecker. I presumed you were.

Mr. Scoll. What would be the minimum earning experience that you would consider in a small loan like that? Five years, 10 years, or how many years?

Mr. Ecker. We normally ask for their experience over the previous 5 to 10 years if they have been in business.

Senator Taft. Do you impose restrictions on other borrowing? You are talking about unsecured loans now, 25 percent of the assets of the company. Do you want a certain length of time? You do not want to make a loan for a year, do you?

Mr. Ecker. No, sir. Ordinarily lending is in the longer-term field because the local banks ordinarily take care of the short-term requirements. Our loans, generally speaking—we make very few loans of less than 10 years, let us say.

Senator Taft. Then you would amortize it from year to year?

Mr. Ecker. On industrial loans we believe very strongly in amortization; yes.

Senator Taft. That would not prevent the banks making short-term loans in between to cover necessary requirements?

Mr. Ecker. That is right, and frequently what is done is that the bank makes the loans or makes a loan in sufficient size to be amortized over the first 5 years and we take the longer term end of the obligation.

Senator TAFT. In other words, you do a joint lending?

Mr. ECKER. Yes, sir.

Senator TAFT. May I ask some general questions?

The CHAIRMAN. May I ask one question before you go into the general questions?

Senator TAFT. Surely.

The CHAIRMAN. Returning to the feasibility of the loans and your requirements, I wanted to refer to the statistical material which we gathered and to which I made reference the other day in a conference with members of the press who are interested in this hearing.

The RFC during the year ended June 30, 1949, made loans to 3,509 applicants. The total amount loaned was something approximating 349 million, which is not very much in the terms of your dealings. But of these 3,509, 49 applicants for more than a million dollars each received approximately half of the total amount, which meant, of course, that approximately 3,400 had to divide the other half. In other words, most of the applicants were for what you would regard as very small loans.

Mr. Gunderson of the RFC Board, testifying before another subcommittee of this committee, the Subcommittee on Fiscal Policy, said that the RFC is very careful in appraising these various loans, and two requirements are laid down: First, that the applicant cannot get the money from any other source and, secondly, that the collateral which is offered and the terms of the loan must be such as in the judgment of the Board would guarantee the repayment to the Government.

It would seem from the general record that by and large that has been a successful policy so far as repayment is concerned, because Mr. Gunderson testified that RFC over the years had made a profit for the Government of about $560,000,000.

I confess I have not had the time to go into all of the details, but assuming that testimony to be correct, the conclusion is that a loan applicant to obtain RFC funds must be a pretty good risk. Naturally, it is your duty to make certain that the loan applicant is a good risk, but you are not bound by this requirement that the RFC has—namely, that the borrower cannot get money from any other source. That is true, is it not?

Mr. ECKER. That is correct, yes, sir.

The CHAIRMAN. So that the only requirement so far as the insurance company is concerned is that you shall be satisfied that repayment can be made.

Now, do you make both secured and unsecured loans?

Mr. ECKER. Yes.

The CHAIRMAN. With respect to the unsecured loans, what are the standards by which you judge the capacity of the applicant to repay?

Mr. ECKER. Now, Senator, it just is not possible for me to set forth here the criteria by which these loans are judged. Each individual case must be studied on its own merits. They are just as different as can be. I am sorry. I would like to be responsive to that question, but it is just not possible to do so.

The CHAIRMAN. I can understand your difficulty.

Mr. ECKER. I would like to clear up this point. I spoke of an equity requirement of 75 percent. I do not want to have even that thought of as a hard and fast rule. It is not. But in thinking of industrial loans generally I would say that in most instances that debt does range around 25 percent of the assets.

Senator TAFT. That is after a loan is made?

Mr. ECKER. Yes.

Senator TAFT. So that it is a third of what they have.

Mr. HAGERTY. Senator, in answering further your question of feasibility. I would like to say that under the New York insurance laws we cannot loan to individuals, we can only loan to corporations. As to unsecured loans, we are bound by certain restrictions in the law that an unsecured obligation of a corporation, the earning power must have been such as to cover the interest charges one and one-half times for 5 years on the average and including the last year. Now, there are a lot of loans that cannot conform.

The CHAIRMAN. Doesn't that almost exclude from the realm of possibility, so far as your loans are concerned, a new enterprise?

Mr. HAGERTY. If the new enterprise had a lot of physical value and a mortgage could be put upon it, we probably could make the loan, but if it is an unsecured loan, a debenture, where you lack the physical property—let's say the plant were leased and the only assets of the borrower were working capital, cash, receivables, et cetera. It would have to be in the form of a debenture, and we could not make that loan without a 5-year record, unless there is a guarantor, a company that did have a 5-year record.

The CHAIRMAN. I want to make it absolutely clear that I recognize and I am sure every member of the committee recognizes completely the obligation of an insurance company to protect the investment of the policyholders. So you cannot take risks. But I am trying to find out to what degree the requirement for protecting against risking your money is an obstacle to little business, local business, new business, getting money, and whether or not there is anything that we can do or ought to do to open an avenue toward the savings of the country for such a little business.

Now, with respect to the last answer of Mr. Ecker, I wanted to point out that yesterday Mr. Bimson, a banker from Arizona, who is a member of the Small Business Advisory Committee of the Department of Commerce, testified here with respect to the desirability of some form of loan insurance. He wanted the Government to manage such a loan, but he wanted to make it absolutely certain that the Government agency authorized to administer such a plan should not have the power to determine the qualifications of the borrower, that that job should be performed by the local banker.

His point was that only the local person, the local banker, who was in immediate contact with the borrower, was best equipped to determine whether or not managerial capacity was there, whether or not earning capacity was there, whether or not the collateral was sufficient to justify taking the risk.

Now, on the other hand, here is a great institution making loans, and it would seem to me to be physically impossible for such institution to have that local contact unless you give a great deal of power and discretion to the local representatives. That leads me to my next question: Who determines whether or not the requirements have been met?

Mr. ECKER. The first decision is made by the people in the field. Now, if you are speaking of an industrial loan brought to us by a banker, it presumably would not be brought to us if he did not feel it was a sound investment. They are not anxious to feed us poor investments, I do not believe.

The CHAIRMAN. You have never, then, found a banker offering a poor investment?

Mr. ECKER. No; I would not say that, but I say I do not think they are anxious to feed us poor investments because obviously that would deter us from doing very much business with them in the future along similar lines.

Mr. LINCOLN. You have said one thing that prompts me to descend to a little lighter vein for a minute, if I may. You spoke of the responsibility of the company to its insurance policyholders.

This young man here, of our staff, was telling a story this morning about a concern out in one of the Midwestern States which had applied for loans, in new industry, but it had the record which warranted our sending him out there.

He went out and looked this thing over and had to report that it was not sufficient for us to make that particular loan. Whereupon, as I understood him to tell us, the proprietor of the institution said, "Well, I am a policyholder of yours"—of say a hundred thousand dollars' worth of policies—"and from that point of view I am glad you don't make such loans."

Senator TAFT. In the industrial field you really are not adding anything much to what people can do except in this intermediate range between short-term and long-term loans; is that about it?

Mr. ECKER. That is right.

Senator TAFT. You cannot under the law invest in common stocks; you cannot put money into the equities of new concerns; either new or old, you cannot loan money except on perfectly secure loans based on earning power, 5 years established. Any banker would loan on similar security if that kind of 10-year loan was something that banks made as a regular practice. They do make them a little but not much.

Mr. LINCOLN. Haven't they trespassed a little in that regard through recent years?

Senator TAFT. Yes; they have, and I think maybe it is a proper field for them. But it is a field in which you also come into in order to assist the situation, though it is not possible for you to undertake equity investments. What is this item on exhibit VII?

Mr. LINCOLN. We have preferred stocks, which are permissible under the State statute, and we have a certain small quota of common stocks which have been acquired through the processes of some reorganization.

Senator TAFT. In other words, they have been wished on you?

Mr. LINCOLN. Growing out of some debt obligation we held and in reorganization a certain amount of common stock might be issued, and we acquire that, and then under the law of New York we are bound to dispose of them within 5 years unless permission is granted by the insurance department to extend that period.

Senator TAFT. As to preferred stocks, are they subject to approximately the same general rules as this 25 percent loan?

Mr. LINCOLN. There is a statutory requirement.

Senator TAFT. Do you limit them to 25 percent of total assets?

Mr. LINCOLN. No; it is a different kind of restriction. We have it all here, but in my five different copies of answers, I cannot find it.

Senator TAFT. Can you tell us legally what you can do under preferred stock?

Mr. HAGERTY. As far as ratios are concerned—is that your question?

Senator TAFT. What limitations are there?

Mr. HAGERTY. We can only buy up to 10 percent of the outstanding preferred stock of any corporation, and then it must have earnings similar to the earnings of a debenture bond I referred to, twice over including interest charges, one and one-half times.

Senator TAFT. You could not undertake to finance a whole preferred stock issue?

Mr. HAGERTY. Ten percent is the maximum allowed by law in New York State.

Senator TAFT. May I ask a general question? What percentage of the total life-insurance industry, is the Metropolitan, just roughly?

Mr. LINCOLN. Do you mean in relation to our insurance in force? We are a little short of one-fifth of all insurance in force.

Senator TAFT. I was thinking of the reserves.

Mr. LINCOLN. That would be one-seventh or one-eighth.

Mr. ECKER. About one-sixth.

Mr. LINCOLN. I will call on Mr. Woodward back there to answer that, if he will.

Mr. DONALD B. WOODWARD (second vice president, Mutual Life Insurance Co. of New York). The total reserves of the industry are $48,000,000,000.

Mr. LINCOLN. We have about eight. That is one-sixth.

Senator TAFT. Are any of the other companies substantially different from yours in the general character of the investments?

Mr. LINCOLN. We are describing the restrictions which apply under the New York law. I think under New Jersey, Massachusetts, and some of those Eastern States they are relatively the same restrictions. I think as you get into some of the other States there may be less restrictive provisions.

Senator TAFT. You would say that roughly speaking, the picture in the whole industry is not much different from that given here in Metropolitan?

Mr. LINCOLN. Not much.

Mr. SCOLL. We have other typical companies coming in from different parts of the country, Senator.

Senator TAFT. I thought I would start now.

Mr. LINCOLN. Maybe you will not be here when they come and you want to get it now.

Senator TAFT. I wanted a general idea.

You make a statement on page 3 of your statement:

> If there is, as some assert, a shortage of equity capital, it is our opinion that any apparent shortage of this kind is attributable to the lack of incentives for investment in common stocks on the part of the general public.

I am inclined to agree with you, but certainly the money that does go into insurance is not available for investment in common stocks anyway.

Mr. LINCOLN. The point is that those people might be tempted out of insurance and into common stocks if common stocks were more tempting.

Senator TAFT. Yes.

Mr. LINCOLN. We might fare a little worse from the insurance point of view if some of these inhibitions were abolished.

Senator TAFT. I think that is true, and your point is that as far as money going into investment in insurance is concerned, that percentage has not been increasing.

Mr. LINCOLN. Right.

Senator TAFT. By reason of any increasing unattractiveness of common stocks.

Mr. LINCOLN. Relatively, as the figures showed there, the percentage of savings through insurance is about static or even less in proportion to the whole savings of the country.

Senator TAFT. But those savings which do go into insurance are not available for equity investment in business.

Mr. LINCOLN. They definitely are not. We cannot use them for that, and the man who sees fit to put his insurance program with us evidently does not want that part of his funds used for common stocks.

Senator TAFT. Branching off into another type of equity: in the field of housing you have a certain amount of direct investment that is not perhaps subject to the risks of industrial concerns, but which is subject to risks that mortgages may not be, $255,000,000 in multifamily real estate direct investments.

Is that increasing or decreasing, or how new is it?

Mr. LINCOLN. We are completing a program—well, if I may go back to 1923, it was first initiated in 1923 when there was a scarcity of housing in New York. Mr. Samuel Untermeyer came forward with a proposal that life-insurance companies be permitted to invest in housing under restrictions, which were as I remember, to rent for not more than $9 per month per room. Previous to that a life-insurance company could not buy real estate at all.

Through Mr. Untermeyer's activities, the law was passed to permit housing, and as a result, one company—I started to say "of course"—I will say it just happened that one company undertook it, to wit, the Metropolitan, and we invested in Long Island City, as I remember it, about $7,000,000 in some housing enterprises out there which have been carried on from that day to this.

Then came the situation in 1938 when there was a good deal of activity on the part of the administration and otherwise to have more employment, and our company then proposed and I remember a telegram was sent to the President stating that the Metropolitan, if the laws of New York would be changed to permit it, would invest $50,000,000 in housing projects.

The insurance department was consulted, the matter was taken up with the legislature, and suitable laws were adopted so that then the Metropolitan then undertook in 1938 the investment in housing known as Parkchester, which was a 129-acre tract in the Bronx, and on which this multiple-family series of houses was put up.

Then after that it was thought that this thing might be tried out as a demonstration on the Pacific coast. Two projects were initiated out there, one in Los Angeles and one in San Francisco. The war came on, there were thousands of handicaps interposed in all directions, but that housing was partially completed, and the garden-type of housing, and right now those two same projects are being filled out with apartment buildings, about 11- or 13-story buildings, on those two projects.

Over here in Arlington the President sent word that he would like to have something erected over there in the neighborhood of the Pentagon Building to satisfy the situation existing during the war. Our people found attractive land, which you may be familiar with, that we know as Parkfairfax, and built another set of houses over there.

Then the New York City authorities were agitating for what they called the slum clearance. Some time I am going to find out what that is. There seems to be a difference of opinion.

But whatever slum clearance is, they had the gas-house district on the East Side, which, after considerable exploration, was acquired through certain legislation and contracts with the city of New York, and we have just recently finished construction of what is known as Stuyvesant Town over there.

At the same time another project was built in the Harlem district called Riverton, and then the company itself put up, without any statutory relationships, another one on the East Side between Twentieth and Twenty-third Streets in that same section, called Peter Cooper Village.

Those are our projects, which have been carried on through the years, and I would say, answering your question, that they probably constitute what the company is prepared to undertake at the moment.

Senator TAFT. I suppose you may have a more complete statement somewhere, but can you tell us, roughly speaking, whether the return on those investments has been a return—on that $255,000,000—comparable to others?

Mr. LINCOLN. I do not think the figures are entirely available. I know that on the earlier one in 1923 it has been perfectly satisfactory, a perfectly satisfactory return with amortization and all included. I think the same is true of Parkchester, which was built between 1938 and 1939.

As to these others, which were started since that time, every one of them ran into all kinds of devilment on the part of the Government, the war, the local authorities; and over here in this Parkfairfax one that you are familiar with, after they got us to start that, then the War Department or somebody clamped down on the steel, we could not have our steel, and we had to live with that sort of thing for 2 or 3 years.

I do not think as as a matter of cost we could make quite the same picture, but now with the elaboration or development of those apartment buildings in Los Angeles and San Francisco, I think the picture is going to be changed very decidedly.

Senator TAFT. You feel that direct real estate investments of the subdivision type or large apartment type are justifiable and sound forms of investment for a certain percentage of insurance-company funds?

Mr. LINCOLN. We certainly do. We are authorized by statute to do that in New York. And, incidentally, where we have gone into these other localities in California, there had to be an amendment to the statute, and I think there was over here in Virginia. There has to be local consideration as well as the New York law.

Senator TAFT. You have only 3 percent, something like that, is it not, of the total investments in that type?

Mr. LINCOLN. Just about.

Senator TAFT. Two hundred and fifty-five million out of eight billion would be somewhere around 3 percent.

Mr. LINCOLN. There is a limitation, but it is broader than that.

Senator TAFT. The limitation is higher than that?

Mr. LINCOLN. Yes.

The CHAIRMAN. May I call your attention, Mr. Lincoln, to your exhibit IV?

Mr. LINCOLN. Yes; if I can find it. Will you give me 10 minutes to find it?

The CHAIRMAN. You will not need that much time; it is right there before you.

Mr. LINCOLN. By the time we got all through with Mr. Scoll's three or four editions of questions, I was pretty well mixed up.

The CHAIRMAN. Well, you have not demonstrated that yet, sir.

Mr. LINCOLN. Let's demonstrate it now. What do you want to know?

The CHAIRMAN. I am going to call your attention to one or two facts that are set forth on this exhibit. The exhibit is authoritative, I take it?

Mr. LINCOLN. It must be. I could not prepare it myself, but we have people who if they do not prepare it right, we will fire.

The CHAIRMAN. Bear in mind what I have said about my own objectives in this hearing, namely, to find out what, if anything, we can do as a government, as a Congress, to create a better opportunity for new business and for small business to obtain loans when that business is well managed and has a reasonable prospect for success. In other words, I only want to open the door to sound investment. Representations are made that little business is not getting the access to savings that it ought to have.

Mr. LINCOLN. Senator, I am going to interrupt you. My colleagues may down me for saying this, but I should think those little business people you have been talking about, might do a darn sight better to come and sit down with us than to come to Government about it, in the first instance at least.

The CHAIRMAN. I would not be surprised. But the fact of the matter is there is constant pressure for some form of government loan.

Mr. LINCOLN. Sure.

The CHAIRMAN. And so the purpose of these questions of mine is to determine how we can make the road open for private investment. I would much rather have private capital operating in the commercial field than have Government capital.

Mr. LINCOLN. I know you would. And I feel if these people sat down with the investment authorities of these different big institutions, they might get somewhere without aid of the Government.

Senator TAFT. May I interrupt you? I do not think they would, frankly, because I think the people who complain they cannot get money want money on a much more liberal basis than you will supply it. My question is whether they are entitled to it at all; my question is whether it is not properly an equity investment and the problem is not to get equity money rather than the type loans they are talking about getting.

Mr. LINCOLN. You are so right.

Senator TAFT. I do not believe the problem we have on the encouragement of small business getting started is going to be solved by the present insurance laws unless you think that some investment in common stocks is desirable for insurance companies up to some percentage of the total.

Mr. LINCOLN. We have been firm in opposition to that through the years.

A very famous speech was made by Mr. Ecker, Sr., who was then president of the company in 1929, and as luck would have it, he made that speech about 2 weeks before the great crash. And at that time people were agitating for life-insurance companies to go into common stock. He made a strong speech here in Washington against life-insurance investments in common stock about 2 weeks before the bottom fell out of everything, and he was thoroughly vindicated, and we have not changed our position since.

Senator TAFT. On the other hand, if tax laws are such, and likely to remain such, that wealthy people will not invest in common stock, and we have billions of dollars of savings of small people, we may have the problem of working out some way by which the savings of the small people are available for investment in common stock on some spread-the-risk theory.

One of those might be to say that any insurance company would be safe enough to invest 5 or 10 percent of their assets in common stock. That might be the policy we might want to have.

Mr. LINCOLN. I started to say—I guess I am out of order. It is not fair to ask whether those income-tax laws will be trued up some so there will be more attraction in common stocks. I do not think that is fair to ask here.

The CHAIRMAN. It is a perfectly fair question.

Senator TAFT. It is one of our main considerations.

The CHAIRMAN. I do not know why you should not be free to ask us any questions you want. Of course, we can give you only personal responses.

Mr. LINCOLN. But I think the Senator will be right in the middle of that before long.

The CHAIRMAN. I cannot imagine what he meant by that, Senator.

Senator TAFT. I do not know, either.

I am not so optimistic about getting the tax laws in shape where we can go back to the days where a few rich men financed Henry Ford, or that sort of thing, in the early days.

Mr. LINCOLN. Is it a case of rich men investing in common stocks or making it so the average fellow would like to have a little flier in common stock which he sees now is all set against him? I do not think I ought to parallel—well, I will not do it. But the whole thing is set against the man that invests in common stock today.

Senator TAFT. I think, going through and taking the small manufacturing industries running through Ohio—and there are hundreds and hundreds of them—I would guess, and this is only guessing, a large number were financed by some fellow, or one or two men in town who were the only ones who had the money and got behind a fellow who had an idea and built up these businesses.

Mr. LINCOLN. Those are not the wealthy individuals within the term you have just used it.

Senator TAFT. Well, they are enough so that I am not optimistic enough to think their tax return is going to be very much reduced by a change in the tax laws which we may make.

The CHAIRMAN. I do not believe, Senator Taft, that you meant the implication of your statement that most small businesses are not entitled to receive any loans.

Senator TAFT. Those that complain most loudly; yes.

The CHAIRMAN. Of course, that is a very different matter.

Senator TAFT. Nine out of ten get the loans.

The CHAIRMAN. I understand, and the testimony which was given here yesterday was pretty emphatic, that there are pretty good risks which cannot find any access to the loans they want.

Mr. LINCOLN. May I ask whether those were given to you on a case basis?

The CHAIRMAN. They were not.

Mr. LINCOLN. They do not tell you what they are and where they are, do they?

The CHAIRMAN. I think the same reasons prompting these gentlemen in proposing accelerated depreciation, for example, in order to promote investment, and asking for some form of insurance loans, are identical with those which prompted Senator Taft when a couple of years ago he himself suggested a Government insurance plan for business loans.

Senator TAFT. May I state again, the reason in my opinion for that is I do not think your tax laws are ever going to be such as to produce again a condition in which you draw equity capital in new business which is a risky business, where you may lose two chances in three. You do not get your money from the wealthier people unless they just like gambling, as some of them do, perhaps. Yet you have billions of dollars of savings in this country. And the small saver, unfortunately, is not the individual in a position where he ought to take a risk. But there is a question whether there is any way to channel the volume of those savings in some way, some part of it, into equity capital, and taking up and providing equity capital formerly provided by wealthier people, which I do not think is going to be provided by them again under any tax laws we can hope to pass, even assuming we do these other things which probably ought to be done to make them more attractive.

Mr. LINCOLN. There is another angle to that. We hear from another committee—and I will be respectful about it—that life insurance companies seek to dominate these businesses. Now if life insurance funds were opened up to equity capital, what could we do except to take part in the management of the business, which in response to some of the questions here we say we do not do.

Senator TAFT. That particular thing never greatly concerned me, not in recent years, so that does not bother me. I am trying to seek the thing I have been more interested in than anything else, and that is how we can get some of the bigger volume of these savings into equity capital.

Most of the small businesses I see, when you come down to analyze their statement, do not get loans because they do not have enough equity capital in the business. And I think it is very good for them to get more of it. I think there is very great difficulty under present tax laws for them to get it.

Mr. LINCOLN. I do not share your pessimism about the tax laws. Of course I do not sit so near them as you do. But it seems to me it would not take too much relaxation in them to turn back into equity capital markets some of these smaller people, not wealthy people. You seem to put the emphasis on wealthy men. I seem to remember in 1929 it was said every grocer and every shoe shiner and everybody else were in the stock market.

The CHAIRMAN. I am inclined to agree with you, Mr. Lincoln, that a sound form of incentive could be provided by modification of the tax law.

But that is not the point to which I wish to draw attention at the moment. We come now to the facts as revealed by exhibit IV, to which I called your attention.

This shows in the first column under "Bonds and stocks"—and by the way, would you mind just identifying the stocks in which these investments are carried so there will be no confusion?

Mr. LINCOLN. There will be a few——

The CHAIRMAN. I do not mean the individual stocks, but what type of stocks. These are not common stocks?

Mr. LINCOLN. There are very few, about $5,000,000. That sounds like a lot to me and you—$5,000,000 of common stock. That is all, and that has all been acquired under some reorganization situation.

The CHAIRMAN. That is right; it was not stock in which you invested.

Mr. LINCOLN. No; we are prohibited.

The CHAIRMAN. In other words, this is the common stocks which you have acquired in the legal reorganization?

Mr. LINCOLN. Yes.

The CHAIRMAN. And it represents out of a total of some $3,342,000,000 only about $5,000,000?

Mr. LINCOLN. Five million.

The CHAIRMAN. So it is insignificant.

Mr. LINCOLN. There are also preferred stocks in there. Do not forget that.

The CHAIRMAN. I think they fall into a different category.

Mr. LINCOLN. Mr. Hagerty says $107,000,000 of preferred stocks; $5.000,000 of common, and the rest bonds.

The CHAIRMAN. So $112,000,000 out of $3,342,000,000 is stocks.

Mr. LINCOLN. Right.

The CHAIRMAN. But you will see in the other tabulation under the heading "Acquired during 1948" that there was only one loan made under $100,000 all through the year 1948. And that loan was for only $29,000.

Mr. LINCOLN. I wish you would let one of my colleagues here speak on this subject a little. I cannot, myself. Do you want to, Harry?

The CHAIRMAN. Just let me analyze these figures here and see if I am right.

Bear in mind, Mr. Hagerty, that a few moments ago I called attention to the great disparity in RFC loans between the large applicant and the small applicant. So I beg of you to understand that there is no hostility in any of these questions that I am asking. I am merely trying to analyze the figures that you gentlemen have presented to me. Because unless we understand the facts, certainly we cannot recommend any legislation that is worth while.

So here on the record, throughout the year 1948, only one business in the whole United States having a need for less than $100,000 obtained such a loan from Metropolitan, and that amount was only $29,000.

Now if you will examine the table above, showing the bonds and stocks owned on December 31, 1948, there were a total of 707 issues valued at $3,342,101,000. Those over a million dollars and up to five million numbered 313, for a total of $855,424,000. From five million one to ten million there were 87 issues valued at $667,804,000. From ten million one to twenty-five million there were 48 totaling $712,631,000. And over twenty-five million there were 23 totaling $986,180,000.

Now if you total the number borrowing more than a million dollars, you have 471, with a total of more than $3,222,000,000. So that only about $120,000,000 was left to be divided among the 107 under a million and above $500,000; the 105 under $500,000 and above $100,000; the 19 under $100,000 and above $35,000; and the 5 under $35,000.

Now that is a total of 236 loans for less than a million dollars, and the total amount of that was, as I say, just about $125,000,000, or $130,000,000.

But if you add those under 100,000 you find there were only 24 such loans for a total of $1,443,000, whereas the 471 that have over a million received $3,222,000,000, plus.

Now does not that analysis of these figures show that with respect to Metropolitan, as with respect to RFC, the bulk of the loans goes to the very large enterprises?

Mr. HAGERTY. Senator, my answer to that is that we are not offered small loans, if you mean by small loans, loans of under $100,000. Very few come to us. Many of those that do, we find they have been to other places and could not get the loans. I think most people would decide what they need is equity capital, as Senator Taft has indicated.

We have told the banks around the country that we would be glad to have them bring us loans. And if the banks would take 10 percent of the loans, we would take the other 90 percent—they are more familiar with those small credits than we possibly could be. None are being brought to us.

The CHAIRMAN. Do you have such a policy?

Mr. HAGERTY. We have, we would do that.

As far as some of the larger loans, they have made money available to small businesses. We have made a loan to Fruehauf Trailer Co. of $30,000,000. That money was to provide capital for the small truckers around the country. Fruehauf Co. was in better position to judge those individual credits than we were. So indirectly we made money available in that way in a big loan to small truckers throughout the country, small and large.

But going back to our desire to loan, if the local bank would take 10 percent of a loan and stay with it as long as we stay with it, we would be glad to do it. They do not bring them to us. I think small loans must originate locally.

The CHAIRMAN. I think so.

Mr. LINCOLN. If the Small Business Committee would get around and talk to Mr. Hagerty we might get somewhere.

The CHAIRMAN. This is really quite a forum, and if the Metropolitan Life Insurance Co. with its executives here is willing to say, as Mr. Hagerty has just said, to the small local bankers of the United States, "If you will take 10 percent of the amount of a good loan for which application is made, we will take the other 90 percent, provided you will stay with it and service it."

Is that your proposition?

Mr. HAGERTY. Provided the loan meets the legal qualifications we have.

The CHAIRMAN. Of course, provided that it meets the legal qualification, and one which you deem to be a good loan.

Mr. LINCOLN. I think you have opened up a big door here because my two financial advisers say they will accept it just as you put it.

The CHAIRMAN. Let's get it on the record. Mr. Ecker, you are saying you will accept that?

Mr. ECKER. Yes, sir.

The CHAIRMAN. And Mr. Hagerty has already said it with the approval of Mr. Lincoln.

Mr. LINCOLN. And the approval of Senator O'Mahoney. I want you in it, too.

The CHAIRMAN. I am in it. I am promoting it.

Mr. LINCOLN. All right.

The CHAIRMAN. Because I do sincerely believe if little-business applicants have a good thing, they ought to have access to the savings of the people.

Mr. LINCOLN. It must be apparent to you with this vast investment problem of ours that we would welcome outlets like these if they are practical, and they are practical. We are looking for them.

The CHAIRMAN. I want the country to know that. I think they probably have an idea that the Metropolitan Life Insurance Co. is a very distant, remote entity. It is difficult to reach.

Mr. LINCOLN. You know better.

The CHAIRMAN. Oh; I have been there.

Mr. LINCOLN. You have been there.

The CHAIRMAN. Yes. In fact, I walked around the old Metropolitan Life Insurance Building before the new one was built when I was going to school in New York City.

Mr. LINCOLN. Do you want me to tell when that was?

The CHAIRMAN. I have no hesitation at all.

Mr. LINCOLN. Well; it was built in 1893, so there you were.

The CHAIRMAN. Not 1893, I was there in 1907.

Mr. LINCOLN. All right.

The CHAIRMAN. Well; now, let's go on.

I have here what purports to be a study of industrial private placement loans for 1948 prepared by E. V. Hale & Co., 327 South La Salle Street.

Was that shown to them, Mr. Scoll?

Mr. LINCOLN. I produced it for my friend here.

The CHAIRMAN. I did not know.

Mr. LINCOLN. I brought it to his attention.

The CHAIRMAN. Good. It is just here before me.

This document on the table, entitled "Industrial Private Placement Loans 1948," part 2, page 6, appears to indicate that the only new enterprise which received a loan from Metropolitan during the year 1948 was the Coosa River Newspring Co., and that was in the amount of $14,000,000 total, of which $8,000,000 was taken by the insurance company in first mortgage bonds. Is that a correct statement?

Mr. HAGERTY. Yes.

The CHAIRMAN. Now the smallest item on this list was a loan to the Duriron Co. for chemical equipment. It was a loan of $185,000, the total amount of which was taken by Metropolitan and secured by notes.

The largest item was $84,000,000 on the notes of Gulf Oil Corp. My understanding is that this Gulf Oil Corp., the whole amount, $84,000,000, was taken by Metropolitan. That is the largest that I have been able to note on this in which the Metropolitan took the whole amount. Is that correct?

Mr. HAGERTY. Yes.

The CHAIRMAN. Then the largest loan was the participating loan for $250,000,000 to the Shell Caribbean Petroleum Co., of which Metropolitan put $100,000,000. These were secured by bonds. And participating in that loan of $250,000,000, were the Carnegie Corp., Metropolitan, Mutual Insurance Co., New England Mutual, New York Life, Northwestern Mutual, Provident Mutual, Prudential, Sun Life, and Travelers. Is that a correct statement?

Mr. HAGERTY. Yes.

The CHAIRMAN. Now it seems to me that those figures, the accuracy of which is not questioned, illustrate the heart of the problem with which the committee is dealing; that the large company gets the bulk of the available capital, the small company has difficulty in getting it.

Mr. LINCOLN. What do you mean by the small company? The small insurance company?

The CHAIRMAN. No; the small borrower.

Mr. LINCOLN. We are looking for them, large and small, and you can imagine what a relief it is to get one of those. If we can get $50,000,000 out on one of those, it takes quite a lot of headaches off of these fellows.

The CHAIRMAN. What are the difficulties with which you have to contend with respect to the servicing of loans to small people? You can service a huge loan to a large borrower without anything like the difficulty, I should think.

Mr. LINCOLN. I suppose they get a smaller rate, too.

Mr. ECKER. There is no difference as far as that is concerned, Senator. In each instance the borrower send his check to us, the lender.

The CHAIRMAN. The only reason I made the statement, Mr. Ecker, was because I have a lively recollection of the testimony in the old TNEC insurance study of the president of the New York Life, as I recall, who, in answer to a question of mine, said that his company at that time was not interested in any loan less than, as I recall the figure, $250,000. It may have been lower than that.

Mr. LINCOLN. I wish sometime we could outlaw the use of that illustration because it is not any good any more.

The CHAIRMAN. This is a good opportunity to outlaw it.

Mr. LINCOLN. We are outlawing it now.

The CHAIRMAN. Let's have the facts.

Mr. LINCOLN. I remember it just as you do, but you still repeat it even down to today. I wish we did not have to.

The CHAIRMAN. Of course, I have before me, Mr. Lincoln, your exhibit No. IV which shows during 1948 you acquired one loan under $100,000, and that was for only $29,000.

Mr. LINCOLN. You quote Mr. Buckner as saying they were not interested. We are interested, and I am sure the other companies are interested.

The CHAIRMAN. What can we do to promote this thing?

Mr. LINCOLN. Let's have a talk with some of these small business fellows.

The CHAIRMAN. Do you have any suggestion other than the one we brought out a few moments ago by the questioning that you would be very happy to have local bankers participate to 10 percent?

Mr. LINCOLN. If these fellows stand pat and you stand pat, I would be glad to issue a formal invitation to the small-business committee to come to see us and keep away from Washington.

The CHAIRMAN. If you will strike out the last statement, sir. I would not want to turn them over to the tender mercy of New York completely.

(Discussion was had outside the record.)

The CHAIRMAN. Are there any questions you would like to ask now, Mr. Scoll?

Mr. SCOLL. I would like to ask Mr. Lincoln a few questions about their Government bond buying and selling policy.

Mr. LINCOLN. I have all the answers here but cannot find them. So let's go along.

Mr. SCOLL. Do you want to wait and take a recess while you find your notes?

Mr. LINCOLN. You try it and then we will struggle with it.

Mr. SCOLL. The schedules which you have submitted show that the largest investment in your portfolio is Government bonds. Do you anticipate Government bonds will continue to be the largest reservoir of your investment?

Mr. LINCOLN. It is very difficult to use a crystal ball on that proposition. They have been for many reasons an attractive form. One reason is the patriotic duty which our company and other companies felt to support the war effort. Another reason was that I think other types of bond investment pretty much dried up about that time, and between the two we acquired quite a lot.

Now I cannot forecast whether that situation, or some other situation, will be controlling next year or 5 years from now.

Mr. SCOLL. In the last 2 or 3 years has your company been a net buyer or seller of Government bonds?

Mr. LINCOLN. They must be a net seller, must be because our holdings have been reduced by 31 percent or 37. I had it here. Do you want it in detail? Mr. Hagerty gives it to me for each of the last 3 years. In 1947 our holdings decreased by 367 million; in 1948 by 498 million; and up to December 1 of this year, by 279 million. And I might add that that was largely dictated by the necessity for supporting the productive enterprise of the country which came to us with applications for investments in other directions.

Mr. SCOLL. Was that the sole consideration, or were there any other factors that entered into your judgment and your decision to sell Governments?

Mr. LINCOLN. I leave it to my colleagues here, because I understand that what motivated us principally was the hue and cry on the part of public and private authorities to support productive enterprise.

And we had these applications for loans, big and little, which could be satisfied if we diminished somewhat our Government holdings.

Mr. SCOLL. If the yield on Government bonds were increased, would that affect your decision to buy or sell Government bonds?

Mr. LINCOLN. I suppose that other interest returns would be correspondingly changed and we would be in about the same status in relation to Government bonds, or other securities, as we are. I cannot imagine Government bond yields increasing without a relative increase otherwise.

Mr. SCOLL. Well, the Government bond yield has something to do with the size of your investment in Government's during this current period, does it not?

Mr. LINCOLN. Well, during the current period I do not know whether we are buying anything but short-terms.

Mr. HAGERTY. We buy nothing but short-term bonds to carry over to the end of the year, probably.

Mr. LINCOLN. Semi cash; maybe more than semi, maybe cash.

Mr. SCOLL. You sort of treat them as cash?

Mr. LINCOLN. Yes.

Mr. SCOLL. Now if the yield on Government's were to be increased, what effect do you think that would have on the yield on private investment of private bonds?

Mr. LINCOLN. It almost follows, as day follows night, that the private investment yield would somewhat accordingly increase. I do not know as they would be pari passu. That is a word I like to use.

The CHAIRMAN. It is very good.

Mr. SCOLL. If that were the case, that an increase in the yield of Government's resulted in an increase in the yield of private investments, would that result in a further switch of insurance funds from private investments to Government's?

Mr. LINCOLN. Not for that reason, I take it.

Mr. ECKER. No. It would be more apt to work the other way.

Mr. SCOLL. What is the answer?

Mr. LINCOLN. The young man here who is our great reliance says we would be locked in. I do not know what he means.

Mr. SCOLL. What do you mean?

Mr. LA FORCE. I meant by that simply this: If the yield on Government bonds increased, the principal value or the market value in the market would be less than par, and we would not sell our Government bonds below cost presumably under most circumstances.

Mr. SCOLL. What is your name for the record?

Mr. LA FORCE. Arnold La Force.

Mr. LINCOLN. He is Arnold La Force. He is one of our very important colleagues, not in quite the status yet of these fellows.

(Discussion was had outside the record.)

Mr. LINCOLN. Mr. Scoll, did you find out what "locked in" means now?

Mr. SCOLL. I think I understand. I want to make sure it is clear on the record.

Mr. LINCOLN. All right.

Mr. SCOLL. Now who are the intermediaries who arrange for these direct private placements? Can you describe them as to their business?

Mr. LINCOLN. Investment bankers; are they not, Harry?

Mr. HAGERTY. Yes; generally investment bankers.

Mr. SCOLL. Exclusively so?

Mr. HAGERTY. Occasionally a mortgage banker, and probably in a few instances individuals. By and large they are investment bankers.

Mr. SCOLL. Who pays them for their services?

Mr. HAGERTY. The borrower.

Mr. SCOLL. Do you do a considerable amount of your private placements through the investment bankers?

Mr. LINCOLN. It appears in the statement which I read first. I think about 50–50; is it not, Harry?

Mr. HAGERTY. I think over the past several years it averaged 50 percent. Last year I think it was roughly 57 percent of the private placements that were acquired through intermediaries.

Mr. SCOLL. But it would be perfectly possible for any of these borrowers to come to you directly; would it not?

Mr. LINCOLN. And they do.

Mr. SCOLL. I believe the pamphlet which the committee put out, Factors Affecting Volume and Stability of Private Investment, showed some very reassuring statistics on the over-all debt equity ratios for corporations as a whole in the United States. Now it is quite possible that any general change in the business cycle might result in an unfavorable change in those ratios.

Now, as the largest insurance lender of funds for manufacturing and industrial enterprises, to what extent have you, or do you give consideration to possible cyclical trends in determining what debt equity ratio is safe for insurance companies?

Mr. LINCOLN. I am going to let these fellows answer that, but remind you ours is a long-time business and our lending is a long-term lending job. Within what are reasonable restrictions, I suppose that feature is also taken into consideration. If I do not get more than 90 percent on that, you answer it.

Mr. ECKER. That is right.

Mr. LINCOLN. I get 100.

Mr. SCOLL. The reason I asked the question is because in your earlier answer your manufacturing-industrial loans have been expanded considerably since the war.

In the event of a decline in business—which we hope, of course, will not occur—do you regard it as the function of the Federal Government to confine its activities to the refunding of private debt, as the Government has done in the past in many cases, or do you believe that the Government should also undertake compensatory investments to make up for the decline in private investments?

Mr. LINCOLN. Should I make a conventional answer and say "No" period?

I think the Government ought to keep out of it in both categories as much as possible unless there is a severest kind of a situation.

Mr. SCOLL. Just casting your eye backward now over the past 20 years, the refunding operations that were done during the thirties were certainly beneficial, were they not, in the home mortgage and farm mortgage fields?

Mr. LINCOLN. Probably owing to the severity of that depression, much of it was beneficial. I am not so sure all of it was necessary.

Mr. SCOLL. Much of that refunding of home and farm mortgages went to the benefit of life insurance policyholders, did it not?

Mr. LINCOLN. I am not sure that would be true in our case. Take the farms for instance. The Senator mentioned the farms. We made every effort to assure the borrower of our willingness to have him carry on, and we made all sorts of adjustments and benefit settlements, and so forth. And I think that is true largely in city loans, as well?

Mr. ECKER. Yes.

Mr. LINCOLN. The company's policy was to help these people to carry through, and so they did not need to go to any Government institution. The more you get the Government toe in the door, the worse this thing becomes. On the one hand you talk about protecting people from risks, in this category; and on another score we are talking about the people taking more risks. And I do not know where I am left.

The CHAIRMAN. Well, of course, Mr. Lincoln, expansion of business and industry, and progress of science, and development of new techniques, all of these involve risks. But at the same time it is only human nature that those persons who acquire savings are most anxious on the whole to provide security for those savings. That is why, on the record that we have here there seems to be a tremendous increase in the relative amount of the people's savings that go into various forms of investment which they regard as being secured. And that involves not only life insurance but involves Government bonds. And it particularly relates to postal savings, where there has been a tremendous increase.

So in this, as in everything else, we have got to have balance between the risk taker and the careful investor. And, of course, the insurance company which is handling the money of the policyholders must be on the side of security.

Mr. LINCOLN. I am just reminded by this question of counsel of the fact that you were good enough to call at our office one time, and I took you up to the farm loan division and you saw the way those people had handled those farms so as to keep the farmer on his property and not have to sacrifice it. Do you remember seeing that?

The CHAIRMAN. That is right. That was one of my very interesting experiences. Because I found in each one of those folders that, in the desire to keep the farmer on his farm and, of course, the desire also to preserve the investment, your farm experts had laid down a 5-year category of farm practices.

Mr. LINCOLN. Farm improvements, buildings, fences, rotation of crops. You saw it all up there.

The CHAIRMAN. Precisely. So that Metropolitan Life Insurance Co. in New York City was telling the farmer in Iowa how to plant his crop, when to plant his crop, and in what particular field to plant it.

Of course, I do not say you were the initiator of this, but I do know that the Agricultural Adjustment Administration had the assistance of some very distinguished farm experts from the life insurance industry in mapping out the AAA plan.

Mr. LINCOLN. I do not think it impolitic for me to say that when Mr. Wallace was Secretary of Agriculture, I believe, he called at our office and had a very intensive interview with our farm loan manager.

The CHAIRMAN. Yes. We went into all of that at the time.

May I call your attention now to exhibit No. V in that same file?

Mr. LINCOLN. Yes, sir.

The CHAIRMAN. There are two questions that I have in my mind as I look at this list of the corporate bond and stock investments of the Metropolitan byproducts and services.

The first of these is whether in the opinion of your investment experts there has been a change in the category of desirable investments; and, secondly, to what extent, if any, Metropolitan undertakes to supervise or counsel or advice management.

Now it would appear from this list that the largest amount of Metropolitan corporate bonds and stocks have been invested in public utilities—$917,748,000. That is at the bottom.

No. 2. Transportation, $778,128,000.

No. 3. Oil and coal, $228,602,000.

No. 4. Chemical, $202,866,000.

No. 5. Steel and iron, $121,468,000.

No. 6. Finance, $117,310,000.

Now it would appear from that the chemical industry, which is a new and expanding industry, stands only four on the list, whereas public utilities and transportation, which are old industries, stand respectively one and two. Oil and coal stands at No. 3, but steel and iron, which is an industry that has expanded tremendously in recent years, is down at No. 5, with only $121,468,000.

Now that position of steel and iron may be due to the fact that so much of the steel and iron industry is internally financed and does not have to come even to the insurance companies for money. But do you have any comment to make upon that?

Mr. LINCOLN. I am going to ask one or both of my colleagues to speak to that. They can do it more authoritatively than I can.

The CHAIRMAN. I will appoint you, Mr. Ecker, to go first.

Mr. ECKER. Our investments are never static. At one period of time we might have a heavier investment in one type of industry than in another. Expansion has been taking place recently in the chemical industry and in the natural gas industry, for example, and the natural gas pipelines and oil pipelines. Consequently a great deal of money has flowed into those areas.

We do not set up any hard and fast rule to say that we will put X number of dollars or X percentage of our assets in building materials, and we will put X percent in electrical equipment, and Y percent in something else. It depends on the need at the time. We find that is a very fluid, changing situation. Does that answer the question that you had?

I would not say that because we had more money in transportation than we do in chemicals that one could draw from that the conclusion that we think more highly of transportation than of chemicals. It depends on the particular company. I think if you drew that conclusion, you were drawing an erroneous conclusion from our operations.

Mr. LINCOLN. Mr. Hagerty has a point there.

Mr. HAGERTY. Public utilities borrow more money and raise more money on preferred stock than industrials. Their debt ratios may be 50 to 60 percent; industrial companies 30 to 35 percent.

The CHAIRMAN. That raises the question which was in my mind—not necessarily a conclusion at all, Mr. Ecker, but I am merely feeling around for possibilities.

Would this indicate that the old and mature industries, like transportation and the public utilities, depend upon debt financing, as you say, whereas the new industry can get equity capital?

Mr. ECKER. No, as far as transportation is concerned, the railroad industries have needed very little capital in recent years. They are not expanding in the sense that the natural gas industry and other industries are.

The power and light companies have, relative to the railroad industry, expanded quite fast. There has been a shortage, as you know, of capacity and distribution. And if they are given a year or two, they will seek larger amounts on the market as will the steel companies and others.

The CHAIRMAN. Would it be proper to assume there are a larger number of, or there is a larger amount of, old investment in transportation than in any of the others?

Mr. ECKER. Yes. Going back 20 or 30 years ago, railroads, next to mortgages, probably represented the largest proportion of an insurance company's over-all portfolio, and it has gone steadily downward because of the greater promise of industrial loans. More money is needed by industry as a whole as contrasted with the railroads.

The CHAIRMAN. What do you do by way of supervising your loans so as to make sure that changing conditions will not weaken the security?

Mr. ECKER. We, of course, follow periodically the financial statements that the borrowers provide us with. And, whenever we enter into any of these so-called direct loans, we require that the borrower must keep us informed periodically of the financial condition of his company.

The CHAIRMAN. When Jesse Jones was running the RFC and advancing money by way of preferred stock to the banks of the country, he frequently required that a representative of RFC should sit upon the board of directors or sit in some important executive position with the company. Do you find it necessary to do anything of that kind?

Mr. ECKER. No; we do not.

Mr. LINCOLN. I think the provision is made by these gentlemen, who are close to it, when the original instruments are prepared to cover such protection as the company should have by way of reports and so forth. And from then on we do not participate in any way, shape, form, or manner in management.

The CHAIRMAN. Do you have any method of changing the obligation of the contract?

Mr. ECKER. Yes, sir.

The CHAIRMAN. You do?

Mr. ECKER. That is frequently done.

The CHAIRMAN. How is that done?

Mr. ECKER. Just by the officers of the borrowing corporation coming in and sitting down and telling us about what has arisen that occasions in their mind a change in the instrument. And in most instances, if it is a sound thing to do from the standpoint of the company, it is also sound from our standpoint as lenders.

The CHAIRMAN. That is from the point of view of the borrower?

Mr. ECKER. That is right.

The CHAIRMAN. Who wants, perhaps, a liberalization of the loan?

Mr. ECKER. That is right.

The CHAIRMAN. How about from the point of view of the insurance company which wants to make the loan more secure?

Mr. ECKER. Once we have made our deal, we do not have the opportunity of changing it.

Mr. LINCOLN. We have written our ticket and we are through.

The CHAIRMAN. Take this Shell Caribbean loan. The Shell Co., of course, is a foreign company, and it is operating abroad. It has $250,000,000 from a group of insurance companies. Now, what steps can you take to make certain that the security does not weaken in any way? There are so many things that are happening on the face of the earth these days, I should think it would be tremendous responsibility to manage such a vast loan.

Mr. ECKER. There are certain provisions in the indenture of a loan such as that, the intention of which is to see that the security for the loan is not lessened, but it is anticipated that over a period of time the loan should get better, other things being equal.

Mr. LINCOLN. I think Harry has something on that.

Mr. HAGERTY. As to that specific loan, we started out and assured ourselves that we had X amount of assets in the way of oil in the ground and other properties in relation to our debt. And we have a provision in there that they always must maintain that ratio. If they sold more oil or gas in an amount that would reduce our equity, they must replace it with cash or other oil or gas. We maintain that ratio steadily.

And, as far as technological changes that may take place over the period that may impair our investment, we try to protect ourselves by amortization, by getting the loan paid off over the period.

The CHAIRMAN. That does not involve, or does it, a change of the original contract?

Mr. HAGERTY. No; that is part of the original contract.

The CHAIRMAN. That you have in your power?

Mr. HAGERTY. Yes.

The CHAIRMAN. When the committee recesses, it will recess until 2:15.

Our schedule was to have Mr. Woodward appear this afternoon. He is standing by for that purpose.

You have been very kind, Mr. Lincoln, you and your associates, in responding to our questions, and I merely want to say that, if you should decide to make any further statement today, the committee will be very glad to have you do it in the light of the questions. Of course, we have not begun to cover this whole field. It is a tremendous field, and there are many questions that would occur to you gentlemen that do not occur to us, doubtless. But merely that you may make your record complete, if you so desire, you may return at 2:15 and make any statements such as you wish.

Mr. LINCOLN. Am I to understand unless we do—and of course we will have to resolve that—I am dismissed?

The CHAIRMAN. That is right.

Mr. LINCOLN. I would like to say to you how much I appreciate your cordial conduct of this hearing, and counsel's. And I think it has more of a bearing, too, because a number of my conferees from the other companies are sitting there, and I do not think they need have any apprehension about their respective appearances up here.

The CHAIRMAN. Thank you.

We will recess until 2: 15.

(Whereupon, at 12:15 p. m., the subcommittee adjourned, to reconvene at 2: 15 p. m. of the same day.)

AFTERNOON SESSION

Present: Senator O'Mahoney (chairman) and Representatives Buchanan and Herter.

The CHAIRMAN. The committee will be in session.

Mr. Scoll, I understand the next witness is Mr. Woodward.

Mr. SCOLL. Yes, sir.

The CHAIRMAN. Very good, sir.

STATEMENT OF DONALD B. WOODWARD, SECOND VICE PRESIDENT OF THE MUTUAL LIFE INSURANCE CO. OF NEW YORK, APPEARING ON HIS OWN BEHALF

Mr. WOODWARD. May I proceed?

The CHAIRMAN. You speak not for the Mutual Life Insurance Co., but as an economist?

Mr. WOODWARD. That is right.

The CHAIRMAN. Though you are second vice president of Mutual Life?

Mr. WOODWARD. That is right.

The CHAIRMAN. Very well, sir, you may proceed.

Mr. WOODWARD. My name, sir, is Donald B. Woodward, and I am, as you have said, second vice president of the Mutual Life Insurance Co. of New York, serving as the head of its research division. I have been employed by the Mutual Life for the past 10 years, and for 7 years prior to that was economist for Moody's Investors Service.

During the last two decades, I have had several periods of service in Washington: First, as a member of the press, and at later times on leaves of absence from either Moody's or the Mutual Life, in the National Recovery Administration to study financial condition of small business, in the Board of Governors of the Federal Reserve System as an economic consultant, in the War Shipping Administration, in the Treasury Department as an economic consultant, and in the Department of State as an economic consultant.

The CHAIRMAN. Mr. Woodward, you are a bureaucrat gone astray; are you not?

Mr. WOODWARD. You are ahead of me, sir, because my next sentence is that I have also done a little teaching. Therefore, I have been involved in the country's three great bureaucracies: private business, Government, and education.

I have been asked to present a brief summary of the operations of the life-insurance business in the American economy, with especial reference to investment. The data I shall present deal especially with the figures covering the entire business as requested by your counsel in his supplement to the questions on pages 213–214 of the committee's booklet entitled "Factors Affecting Volume and Stability of Private Investment."

Subsequent witnesses have been asked to present data on the individual companies. The figures I shall use have been mostly developed by the life-insurance industry and not by me, but I believe them to be accurate and valid.

I am deeply indebted to Dr. James J. O'Leary, director of investment research of the Life Insurance Association of America, and his staff, as well as to the staff of the research division of the Mutual Life Insurance Co. of New York, for aid in developing the material I am to show you. But, for the selection of the data, the form in which presented, and the comments to be made, I am solely responsible. This is not a presentation by the life-insurance business nor by the Mutual Life of New York.

Life-insurance investment funds are the premiums paid by policyholders, plus income from assets, less payments made to policyholders and their beneficiaries, and expenses of operation. There are presently about 80,000,000 policyholders in this country's 150,000,000 population, and I think it is a fair assumption that a large proportion of the nonpolicyholders are dependents of those who hold policies. I think it will be helpful to look briefly at how the investment funds, in which you are particularly interested, arise.

In 1948, there were about 40,500,000 families in the United States, and the total life insurance in force was equal to about $4,800 per family. This was not quite equal to the average 1948 personal income per family of $5,232. Over the past, there have been years when life insurance exceeded 1 year's income, and others when it was less than 1 year's income. As of early 1949, the Federal Reserve Board survey indicated that 79 percent of the family units of the country owned life insurance. All this information is shown on chart I, which reveals average life insurance per family and average income per family each year since 1929.

I am sure you will realize that the growth in the totals is in part a function of the rise in the price level, or the fall in value of the dollar during recent years; in dollars of constant purchasing power—that is, dollars adjusted for change in purchasing power—the increase in life insurance per family from 1929 to 1948 was 4 percent compared with a rise of 45 percent in dollars, as shown in the chart; and the increase in personal income per family was 31 percent compared with a rise of 83 percent in dollars, as shown in the chart.

The CHAIRMAN. How do you measure the rise in life insurance per family and the increase of personal income as set forth in this sentence, having made adjustments for the inflationary aspects?

Mr. WOODWARD. The figures for life insurance in force are those reported for the entire industry, and I shall subsequently have a chart showing that. The numbers of families are those reported by the Census Bureau and estimated for intervening years. The adjustment for price level uses the Consumers Price Index, popularly called the Cost-of-Living Index.

The CHAIRMAN. I do not know how you get the 4 percent.

Mr. WOODWARD. Well, 4 percent is the increase in insurance per family after allowing for the fact that the price level has risen so substantially from 1929.

The CHAIRMAN. In other words, you make an adjustment of the dollar amount of the insurance on the basis of inflation?

Mr. WOODWARD. On the basis of the cost of living.

The CHAIRMAN. So, the accuracy of that comparison depends wholly upon the accuracy of the adjustment you make?

Mr. WOODWARD. But that adjustment solely uses the Bureau of Labor Statistics index, but your statement is correct.

The CHAIRMAN. So that the statement you make shows that, although personal income has increased 31 percent in this period, the insurance has increased only 4 percent?

Mr. WOODWARD. Corrected for price change; that is right, sir.

Personal saving in the United States in 1948 was equal to $296 per family, which means that personal saving amounted to a little more than 5½ percent of personal income in that year. Of this amount, saving in life insurance accounted for just under one-third, and all other forms of personal saving to a little over two-thirds. Saving in life insurance thus equaled about $95 per family. These figures of average personal saving per family and average saving in life insurance per family are shown on chart 2 for each of the past 20 years.

Here again the figures are affected by price change, and that part of the curve showing the slump of the thirty's would be somewhat smoothed if adjustment were made to put it in constant dollars, and also the highs of recent years would be reduced if adjusted to prewar purchasing power. Please note that the saving in life insurance is a great deal more stable than the total of personal saving, as shown on the chart; I think this is quite significant in this inquiry.

You gentlemen are as aware as I am that the method used to express these facts is not a statement that, for example, each family in this country saved a total of $296, of which $95 was saved in life insurance in 1948. There are, of course, wide variations among families. But I think this method of expressing the figures makes the figures more comprehensible and meaningful so that they may show the trends more clearly.

Let me now turn to the life-insurance company figures. The flow of premiums from the many millions of policyholders, plus the income earned on the funds held by the life companies for the policyholders and their beneficiaries, amounted in 1948 to 8.4 billion dollars. I expect you want to know what the companies did with all that money.

An amount equal to about 37 percent of it was paid out to policyholders and beneficiaries, and an amount equal to 39 percent was put into reserves to pay future claims. The balance is made up of four items: First, increase in special reserves and contingency funds, 6.6 percent; second, expenses, 15.3 percent; third, taxes, 1.6 percent; and finally, dividends to stockholders in stock companies, one-half of 1 percent.

These percentages add to 100 percent, and account for the 8.4 billion dollars of incoming funds. The total of funds flowing to the life companies, and what they did with those funds, is shown for each year of the last 20 years in chart II.

The total reserves accumulated to pay for future claims amounted to 48.2 billions of dollars at the end of 1948. In addition, there was a total of 7.4 billion of dollars, of which the chief items were contingency and special reserve funds of various kinds amounting to 3.8 billions, and 1.7 billions of dollars of dividends due to policyholders. Total assets thus were 55.6 billions of dollars. These assets secure the 207 billions of dollars of insurance in force plus the amounts held for annuitants and the amounts held for beneficiaries of previous policyholders now dead. Chart IV shows the amount of reserves held, the total of assets, and the total insurance in force for each of the past 20 years. That, Senator, is the one I said I would come to a moment ago. Let me remind you still again that adjustment of these figures for the depreciation in the value of the dollar would greatly diminish the increase shown.

And let me remind you again that while these totals appear big, they arise from scores of millions of people. You will recall from my earlier statement that the $207,000,000,000 of insurance in force is equal only to $4,800 per family and is equal to less than the income per family for the 1 year 1948. And the total of assets is equal to less than $1,400 per family. These assets are, I believe, the subject you especially wish to consider.

These assets, 55.6 billions of dollars which were held to pay future claims, are invested to earn as much as possible consistent with safety of principal. These earnings on investment are very important to policyholders, for investment earnings serve to reduce the cost of life insurance. If there were no earnings on investment, policyholders would have to pay more for their life insurance.

In 1948 the average gross rate earned on assets was 3.2 percent, which after deduction of investment expenses, leaves a net rate of 2.9 percent. These figures are for a sample of companies covering a significant proportion of the assets of the entire business, as compiled by the Metropolitan Life. They do not take into account any capital gains or losses. The return on assets during recent years is much lower than that realized in earlier periods—as the chart shows, there has been a very considerable decline over the years—if the rates of earlier years were being realized today, the cost of life insurance could be somewhat lower than it is. The gross rates on assets for each year from 1875, and the net rates since 1905, are shown in chart V.

Now I shall show where these assets are invested.

These assets are invested literally all over the United States, and, to a small extent, outside; preponderantly the investments outside the United States are in Canada. Within the United States, investments are larger than reserves held for some parts of the country and smaller than reserves held for other parts of the country. This map, chart VI, which is based on figures covering 49 leading companies, shows the ratio of investments to reserves for each major region of the country.

You can see that investments are less than reserves held for residents in New England, the Middle Atlantic States, and the East North Central States—that is, the ratio of investments to reserves held for residents of those regions is less than 100. But in all the other regions investments exceed reserves, and in the Southwest are much more than double.

The CHAIRMAN. Does that imply that better investments are found in the Southwest, in East South Central, in Mountain, and in South Atlantic and in Pacific than elsewhere?

Mr. WOODWARD. May I give you my interpretation, which I am about to give?

The CHAIRMAN. I am sorry.

Mr. WOODWARD. What I think this situation means is that the life-insurance operation is acting like a huge pump, taking funds out of the Northeast and putting them into the West, the Middle West, and the South. And this is appropriate, for the South and West are growing more rapidly and have greater need for the funds. Life-insurance investment thus is evidently highly responsive to economic needs.

Let me now turn to the types this investment takes.

These assets are used to aid the three chief economic activities in which society engages: First, to produce the goods and services we need; second, to provide homes; and third, to finance Government. On September 30, 1949, the largest single item was United States Government securities, of nearly $14,000,000,000.

This was followed by real-estate mortgages of $10,000,000,000, public utility securities and industrial and miscellaneous securities, each of which two groups accounted for nearly $9,000,000,000. The total of these four groups—Governments, mortgages, public utilities, and industrial and miscellaneous—thus accounted for about 42 of the 52 billions of dollars of assets which was held on September 30, 1949, by 49 leading companies for which detailed figures are available. My earlier figures were for the entire business. The balance was made up of issues of other governmental units, railroads, policy loans, cash, and a group of smaller items. The distribution of assets for the 49 companies is shown by chart VII as at September 30, 1949.

The amounts of funds invested each year in the provision of life insurance for the 80,000,000 policyholders, and for annuitants and beneficiaries of previous policyholders now dead, is substantially greater than the increase in assets arising from the growth of reserves and safety margins. This is true because, in addition to cash arising from the excess of premium and investment income over benefit payments and expenses, much cash arises from investment repayment. You realize that most obligations of business enterprises and home owner are amortized—that is, are repaid by installments over the life of the obligation.

This is, of course, a very healthy procedure, as Congress recognized in requiring it for both home-mortgage loans insured by the Federal Housing Administration and guaranteed by the Veterans' Administration. In addition to these amortization payments, many borrowers each year repay their obligations in total by call or redemption and, in addition, the life companies sometimes have reason to sell some of the investments they hold.

The result is that the amounts to be invested each year substantially exceed the growth of assets in most years. Thus in 1948 the increase in assets was something more than 3 billions of dollars but the amount to be invested was a little over 9.8 billion. During the first 9 months of this year, 1949, these figures were respectively 2.3 and 5.7 billions of dollars. This is shown by chart VIII.

Now I shall break that down into major constituent groups.

You may be interested in seeing the extent of these differences between increases in assets and total acquisitions for the major asset groups. In 1948 acquisitions of bonds were nearly six times the net increase in bond holdings, 1948 acquisitions of mortgages were some 58 percent more than the net increase in mortgage holdings, and acquisitions of other assets were about double the net increase.

During the first three quarters of 1949, bond acquisitions were about four times the net increase in holdings, mortgage acquisitions were about 66 percent more than the net increase, and acquisitions of other assets again were about double the increase in assets. These facts are shown on chart IX.

What this all means is that the investment process is a treadmill, on which the companies must run several steps forward in order to advance one step.

But this very fact is fortunate, not only because the debt repayment which causes it is healthy to the borrowers, but for another reason as well. This is that the life companies are thus enabled to be even more responsive to economic need than they would be if they invested each year only the net increase in assets.

Thus while in 1948 the net increase in assets was something over $3,000,000,0000, the total for investment was about a fifth of total assets. The result of that is that life-insurance funds can thus flow rapidly to areas of economic need which can provide investment instruments suitable for such funds.

Mr. HERTER. I wonder if I might stop you for a moment to be sure I understand what you are talking about here.

You have not broken down the various factors that go in to make up the difference between your net assets and your net investment, increase in funds available for investment?

Mr. WOODWARD. No, sir; I have not.

Mr. HERTER. You have lumped them, generally speaking. What is the largest one? Is it repayment or partial payment on account of obligations?

Mr. WOODWARD. I can tell you partly at least the answer to that, Mr. Herter.

In 1948, as I said, the total amount to be invested was $9,800,000,000. That was made up of a net increase in assets of 3.2 billion dollars and the balance, which would be about 6.6 billion dollars, resulted from repayments and dispositions. Of that $6,000,000,000 that was not the increase in assets, $5,241,000,000 arose from payments on or sale of bonds.

Mr. HERTER. When you say "payment on," you mean maturities?

Mr. WOODWARD. Maturities, amortization, sinking fund—that kind of thing—5¼ billion dollars from bonds, a billion from mortgages, a quarter of a billion from policy loans, and a few other miscellaneous items.

Mr. HERTER. Principally maturities of one kind or another?

Mr. WOODWARD. That would vary from year to year. Back in the thirties and early forties, when the interest rate was falling very fast, corporate borrowers were refunding their obligations to get a lower rate, and at that time a great part would be the call of bonds for redemption. At other times it would be a different set of factors.

Mr. HERTER. There is really a shifting of investment of $5,000,000,000 as against $3,000,000,000 of net assets?

Mr. WOODWARD. That is right.

Mr. HERTER. Thank you.

Mr. WOODWARD. Your counsel's supplementary questions ask for further detail on some of these assets. This detail is not available for so many companies as have been included in the previous figures, but the Life Insurance Association has been able to obtain it for 17 companies, which have about $39,000,000,000 of total assets, of which 5½ billion are in urban mortgages and nearly $14,000,000,000 in corporate bonds. For these companies I can show you, as requested, considerable detail on corporate bond and mortgage holdings and acquisitions.

Urban mortgages: These companies had at the end of 1948 some 43 percent of their urban mortgage holdings in one- to four-family homes, 22 percent in multifamily structures, and 35 percent in commercial structures. That is shown on the right-hand side of the chart. Their mortgage acquisitions in 1948, however, were much more heavily concentrated in one- to four-family homes, these accounting for two-thirds of total urban mortgage loans made. These facts are shown on chart X.

Mr. HERTER. Do you care to interpret that as you go along?

Mr. WOODWARD. I shall have considerable detail on this.

Mr. HERTER. Thank you.

Mr. WOODWARD. Turning to bonds, which are on this same slide, I take it there is evidently some interest in those loans to corporations which are made directly by the companies. Of the bond holdings of these 17 institutions at the end of 1948, just about half had been made directly and the other half otherwise, primarily through the market. But of acquisitions in 1948, a little more than two-thirds were acquired directly.

I shall now provide some detail on the commercial mortgage loans and on the bonds acquired directly and indirectly from borrowers, these being the two areas in which you wish more complete explanation.

The commercial mortgage loans held by these 17 companies at the end of 1948 amounted, as chart X showed, to $1,958,000,000. These companies in 1948 made $338,000,000 of such loans. Of these, about 98 percent were in amounts of $25,000 or more. I have four tables which set forth details of these commercial mortgage loans of $25,000 or more.

Table I shows the distribution by size of loan for these mortgage loans made to business in 1948 in amounts of $25,000 or more. You will see that 61 percent by number were in loan size of less than $100,000, and that more than half of the dollar amounts involved were in loans of less than $500,000.

Table II shows these loans made in 1948 distributed by asset size of obligor. The previous one had been the size of the loan. Here you will see that more than half by number were to borrowers with assets of less than $200,000, and that more than half by amounts went to obligors with assets of less than $1,000,000.

Table III shows the type of properties on which these loans were made. You can see that nearly half were on retail stores and warehouses, and nearly a fifth were on general office buildings, and the rest run on down in amounts.

Table IV shows the geographic division of these mortgage loans to business in amounts of $25,000 and more. You can see that they were widely spread. The largest number and largest amount were in the Middle Atlantic, where there is the heaviest concentration of population, but they were widely spread throughout this country and the Dominion.

I have four more tables which show for each geographical division the numbers and amounts of these loans, broken down to show for each region the distribution by loan size and obligor assets. I shall be glad to show this still greater detail to the committee now, or to place these four tables in the record for your future consideration.

The CHAIRMAN. Why not describe them now?

Mr. WOODWARD. All right, sir. Table V shows the distribution by geographical region of the loans by size of loan, with the number of loans. Thus, for example, for New England you will see that there were no loans under $25,000—I have excluded them from the tabulation—there were 40 from $25,000 to $50,000, 55 from $50,000 to $100,000, and so on down scattered across the table.

Table VI shows these same loans distributed geographically and by size of loan, but with amounts—the previous one having shown numbers. You will see that in New England there were $1,412,000 of these loans in loan sizes between $25,000 and $50,000 and that in New England there were $3,373,000 in loan sizes of $50,000 to $100,000, and so on, distributed across the table.

Table VII shows these same mortgage loans this time distributed geographically by asset size of the obligor, the previous tables having shown the distribution by size of loan, and this table VII is by loan numbers. You will see thus in New England that there was one under $25,000, 5 between $25,000 and $50,000, 28 between $50,000 and $100,000, and so on.

Table VIII shows the same information, this time by dollars, the previous table having shown it by numbers. That is, it shows for geographical regions by asset size of obligor the dollar amounts of these loans.

That is the detail for these commercial mortgage loans to business in amounts of $25,000 or more. The balance of the mortgage loans, you will recall, were in one- to four-family houses or in multifamily structures.

The CHAIRMAN. How many categories will you discuss?

Mr. WOODWARD. In the bonds?

The CHAIRMAN. Commercial mortgage loans.

Mr. WOODWARD. I have discussed commercial mortgage loans. I shall now discuss the bonds, dividing them between those directly placed and those not acquired through direct——

The CHAIRMAN. But what other categories are you going to discuss, too?

Mr. WOODWARD. In the bonds? My tables will break this information——

The CHAIRMAN. The categories of loans. We have got commercial mortgage loans——

Mr. WOODWARD. That is right.

The CHAIRMAN. You have bonds——

Mr. WOODWARD. Yes, sir.

The CHAIRMAN. Now, you have farm mortgages.

Mr. WOODWARD. Yes.

The CHAIRMAN. Have you city mortgages?

Mr. WOODWARD. City mortgages I have just covered. I called them urban mortgages.

The CHAIRMAN. Is there any other category?

Mr. WOODWARD. No, sir; not that I have in this prepared statement, but I would be glad to go into any other asset groups. These were the two particularly responsive to counsel's questions for detail, but I will be prepared to go into any other.

The CHAIRMAN. Very well.

Mr. WOODWARD. I now turn to the bonds. You will recall from chart X that approximately half of those held were directly purchased from borrowers, and it is this group on which more detail is asked.

Table 9 shows for the portfolio held at the end of 1948, the amounts of these loans by size of obligor, separately for railroad, public utility, and industrial and miscellaneous. You can see that just about half of these were loans to businesses with less than $100,000,000 in assets. These are the direct placements held in portfolio.

Table 10 provides the comparable information for acquisitions of direct placements made in 1948.

What I have shown on the bonds, to recapitulate, is the break-down by size for the loans held and the break-down by size for the acquisitions in 1948, both for direct placements.

Now, gentlemen, I have 10 other tables showing information on both the direct loans and those acquired other than directly from obligors, by railroads, public utilities, industrials, and by obligor size. I am prepared to go over them with you now, or to put them into the record for your future consideration as you may wish.

The titles, I should say, are listed here in my prepared statement:

TITLE OF TABLE

Table XI. Direct placements of railroad, public utility, and industrial and miscellaneous bonds—1948 combined portfolios of 17 major United States life-insurance companies, percent of total dollar amounts by size of obligor.

Table XII. Other than direct placements of railroad, public utility, and industrial and miscellaneous bonds—1948 combined portfolios of 17 major United States life-insurance companies, dollar amounts by size of obligor.

Table XIII. Other than direct placements of railroad, public utility, and industrial and miscellaneous bonds—1948 combined portfolios of 17 major United States life-insurance companies, percent of total dollar amounts by size of obligor.

Table XIV. Direct placements of railroad, public utility, and industrial and miscellaneous bonds—1948 combined acquisitions of 17 major United States life-insurance companies, number by size of obligor.

Table XV. Direct placements of railroad, public utility, and industrial and miscellaneous bonds—1948 combined acquisitions of 17 major United States life-insurance companies, percent of total number by size of obligor.

Table XVI. Direct placements of railroad, public utility, and industrial and miscellaneous bonds—1948 combined acquisitions of 17 major United States life-insurance companies, percent of total dollar amounts by size of obligor.

Table XVII. Other than direct placements of railroad, public utility, and industrial and miscellaneous bonds—1948 combined acquisitions of 17 major United States life-insurance companies, number by size of obligor.

Table XVIII. Other than direct placements of railroad, public utility, and industrial and miscellaneous bonds—1948 combined acquisitions of 17 major United States life-insurance companies, percent of total number by size of obligor.

Table XIX. Other than direct placements of railroad, public utility, and industrial and miscellaneous bonds—1948 combined acquisitions of 17 major United States life-insurance companies, dollar amounts by size of obligor.

Table XX. Other than direct placements of railroad, public utility, and industrial and miscellaneous bonds—1948 combined acquisitions of 17 major United States life-insurance companies, percent of total dollar amounts by size of obligor.

Mr. SCOLL. These tables are all in the groups that you have distributed, are they not?

Mr. WOODWARD. Yes, sir; they are.

Mr. SCOLL. So that the members of the committee have them in front of them?

Mr. WOODWARD. Yes, sir.

Mr. Scoll. Why do you not go on, Mr. Woodward, to page 10 and then members of the committee will want to ask you questions about these various tables.

Mr. Woodward. We can come back to them if it is your wish.

This completes the information which has been prepared to try to give you a summary of the chief facts about life-insurance operations with special emphasis on investment. As I am sure you all know, the facts I have given you are only a small fraction of the detail that exists or could be developed. My judgment as to what would be especially relevant for your present purposes may have been faulty, and if these data have not met your points of especial interest, I apologize.

But life insurance, like a Congressman, lives in a goldfish bowl. So if there is other information you wish, you have only to ask. I shall make every effort to provide it today, or if it is not at hand, to provide it for the record shortly.

But before I close, I would like briefly to make two general points.

The Chairman. Before you proceed to the conclusion, may I ask you the size in assets of the smallest of the 17 majors on the basis of the operations on which these tables have been prepared?

Mr. Woodward. You mean the size of the borrower, the obligor's assets?

The Chairman. The size of the insurance company.

Mr. Woodward. The size of the insurance company?

The Chairman. Yes. You have given us figures from the combined portfolios of 17 major United States life-insurance companies.

Mr. Woodward. That is right. What is the smallest of the life-insurance companies in that list?

The Chairman. That is right.

Mr. Woodward. May I have that prepared for me?

Or perhaps Mr. O'Leary can answer that.

Mr. James J. O'Leary (director of research, Life Insurance Investment Research Committee). Slightly under $500,000,000.

Mr. Woodward. We can provide the names of the 17 for the record, and we will make a note to do that.

The Chairman. With the asset size.

Mr. Woodward. Yes, sir.

(The information referred to is as follows:)

Total admitted assets of 17 life insurance companies Dec. 31, 1948

[Thousands of dollars]

Aetna	$1, 499, 817	Northwestern Mutual	2, 291, 225
Connecticut General	685, 881	Penn Mutual	1, 180, 837
Connecticut Mutual	724, 290	Provident Mutual	594, 873
John Hancock	2, 464, 642	Phoenix Mutual	477, 891
Massachusetts Mutual	1, 234, 397	Prudential	7, 846, 102
Metropolitan	9, 125, 145	Travelers	1, 775, 027
Mutual Benefit	1, 179, 551	Union Central	604, 648
Mutual Life	1, 997, 142		
New England Mutual	997, 832	Total	39, 127, 670
New York Life	4, 448, 370		

Mr. Woodward. The array of information presented here today may suggest that life insurance is a complicated process. But, even so, what has been shown here far understates its complexity of detail. The fact is, and I want to emphasize it, that this life-insurance process operates in a far more complex and intricate manner than many people seem to realize.

Life insurance consists of 584 different companies, some located in every State in the Union, except Wyoming——

The CHAIRMAN. It is the climate that protects us out there.

Mr. WOODWARD. It is a wonderful climate. Many operating in different States, with assets ranging from a few thousand dollars to many billions of dollars, making loans and investments of almost every conceivable size and type and in literally every part of the country. And even the loans the companies make do not anywhere nearly show the pervasiveness of the effects of the companies' operation because many of the investments are made to concerns which in turn finance customers and smaller business units.

Thus, one large loan by one large company may in fact be the vehicle by which hundreds of smaller business units are in fact financed. And many residential mortgage loans and many policy loans provide funds to finance small business.

And yet with all this complexity of detail, sight should not be lost of the over-all simplicity of the process of life insurance. It is simply a process whereby millions of individuals pool funds to meet the risks that their dependents may suffer financially from their death or disability. And since individuals preponderantly wish to pay for this protection on the installment plan in advance, reserves to make possible those future payments are necessary. And these reserves must be invested. This investment, on the one hand, provides interest which reduces the cost of the protection, and on the other hand, provides relatively a very stable flow of funds which help in the production of the goods and services which society needs, the homes it needs, and its government. It is a most beneficial process to society.

The CHAIRMAN. It is an example of the desire of the American people for security?

Mr. WOODWARD. That is correct, sir.

The pervasiveness of life insurance operations means that the life-insurance companies have a great responsibility. That responsibility is directly to the millions of policyholders; and these policyholders and their beneficiaries account for the most of the population of the United States.

The 10 years that I have been in the business have demonstrated to my satisfaction as an economist, that the trustees and officers of the life-insurance companies recognize these responsibilities, are acutely aware of them, and make the utmost honest and sincere efforts to meet them. I do not want to contend that life-insurance companies perform to absolute perfection, because no group of men can make that claim.

But I do believe that life insurance men are not more frail than their brothers and sisters in other lines of activity of any kind and, indeed, there is something in the record of stability and growth and prompt meeting of claims, which could suggest that the life-insurance business is a little less afflicted with human frailties than some other groups in our society.

One major evidence of the sincere efforts to meet these responsibilities is of considerable significance in this inquiry. During the last decade and more, life-insurance companies have undertaken a vastly broadened program of economic and financial research in order to try better to meet their vast responsibilities. Many of the individual companies now have economic research divisions or departments and a great many of them carry on extensive research in connection with their investment and also their sales operations.

But beyond their individual research endeavors, a large number of the companies joined together about 5 years ago to create the life insurance investment research committee to carry on even broader and more comprehensive analysis.

The chairman of that committee is Mr. Frederick W. Ecker, financial vice president of the Metropolitan Life Insurance Co., who was here this morning, and the director of research is Dr. James J. O'Leary, to whom I have already referred, and the committee has expended during its life so far $490,222 and has outstanding commitments of $251,000, in addition. The chief objects of research have been of very broad economic character. I want to mention three of these projects in which I believe you will be especially interested. The first is a comprehensive study of the capital markets in the United States, covering both bonds and mortgages. This study is also developing, for the first time in history, the facts of investment experience in urban mortgage loans, farm mortgage loans, and corporate bonds. A vast array of information is now becoming available to guide the companies and any other interested groups in the formulation of policy.

The second is a study of savings in the United States and the use of those savings. From this study material presently will be available to permit a very much better and more complete understanding than has hitherto existed or been possible of the processes of savings and investment in the American economy over the first half of the twentieth century or longer.

And finally, there is just now being started a major research project to try to find out the prospects for investment and availability of funds over a period of future years. This is, perhaps, and I say it as a research man, one of the most difficult research projects that has ever been undertaken and its results and findings should be of the greatest importance, not only in the formulation of life insurance investment policy but in formulation of business and public policy generally regarding the entire economy.

The method by which these inquiries are being carried out provides, perhaps, the strongest evidence of all of the sincerity with which the life-insurance companies are seeking facts. Each of the three major projects that I have just discussed has been put in the hands of thoroughly responsible and impartial bodies which life-insurance companies do not control.

The companies have simply satisfied themselves of the competence and responsibility of the research groups and have provided them with the funds to make the studies. The companies seek true facts with no slanting. Only the true facts with no slanting could be worth anything as a guide to future policy. There will thus be no reason for anyone to doubt the objectivity and unbiased nature of the findings. I know of but few other cases where a major industry has been so open, objective, and farsighted.

The facts disclosed by these investigations are of the utmost relevance to the subject matter of this committee. I hope that when the results are available, if you gentlemen are still pursuing this subject, that this committee will care to consider them.

(The charts and accompanying tables referred to by Mr. Woodward are as follows:)

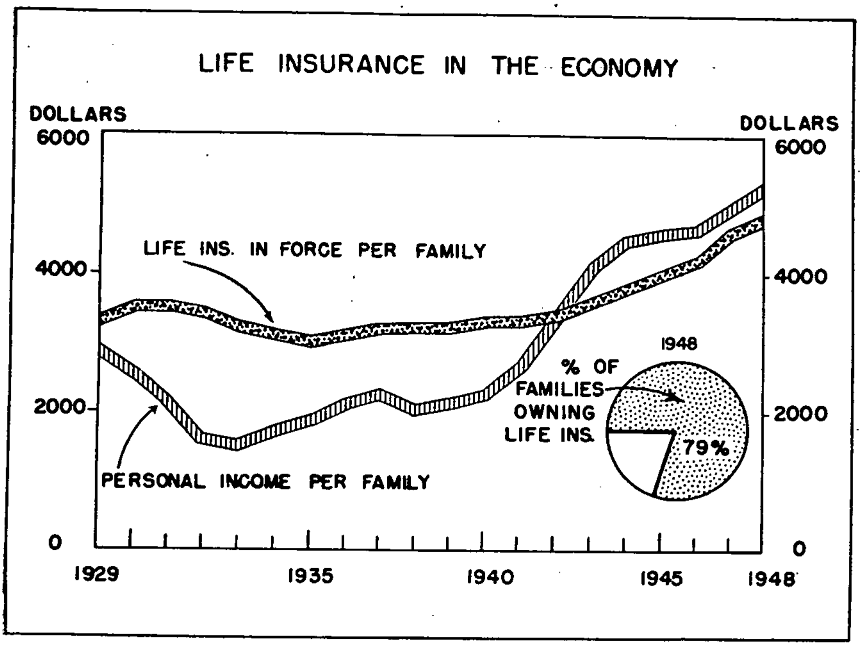


CHART I.—*Life insurance in the economy*

	Life insurance in force per family	Personal income per family	Proportion of families owning life insurance
			Percent
1929	$3,300	$2,859	
1930	3,500	2,548	
1931	3,500	2,133	
1932	3,400	1,600	
1933	3,200	1,498	
1934	3,100	1,686	
1935	3,000	1,861	
1936	3,100	2,090	
1937	3,200	2,224	
1938	3,200	2,021	
1939	3,200	2,112	
1940	3,300	2,242	
1941	3,300	2,659	
1942	3,400	3,367	
1943	3,600	4,076	
1944	3,800	4,471	
1945	4,000	4,585	
1946	4,200	4,634	
1947	4,600	4,949	
1948	4,800	5,232	79

Source: Institute of Life Insurance; U. S. Department of Commerce, Office of Business Economics and Census Bureau; and Federal Reserve Board.

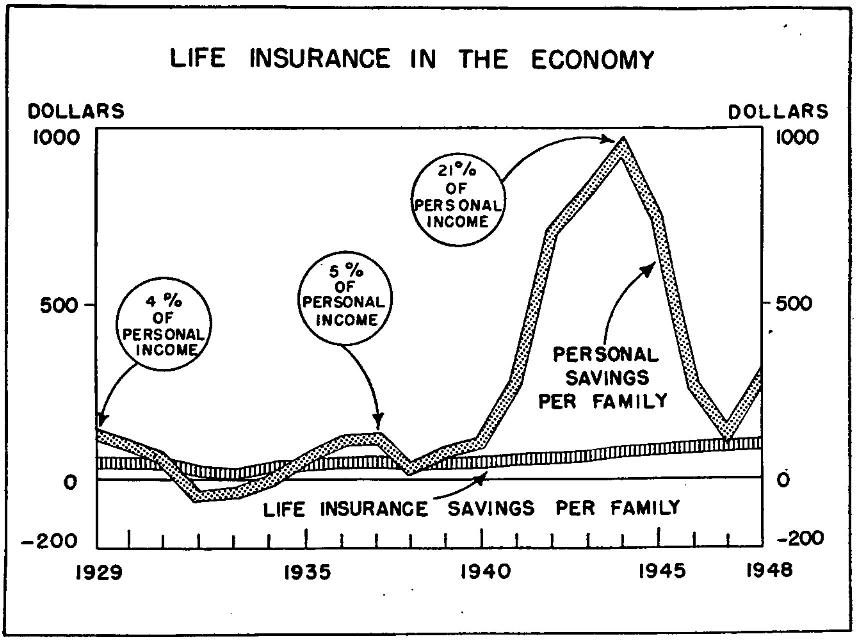


CHART II.—*Life insurance in the economy*

	Personal savings per family		Life-insurance savings per family		Personal savings per family		Life-insurance savings per family
	Dollars	Percent personal income			Dollars	Percent personal income	
1929	125	4	$49	1939	79	------------	$45
1930	97	------------	48	1940	106	------------	47
1931	60	------------	43	1941	272	------------	55
1932	−45	------------	22	1942	702	------------	61
1933	−38	------------	16	1943	819	------------	68
1934	−8	------------	32	1944	954	21	78
1935	55	------------	43	1945	746	------------	84
1936	109	------------	48	1946	271	------------	86
1937	118	5	48	1947	129	------------	91
1938	28	------------	46	1948	296	------------	95

Source: U. S. Department of Commerce, Office of Business Economics and Bureau of Census.

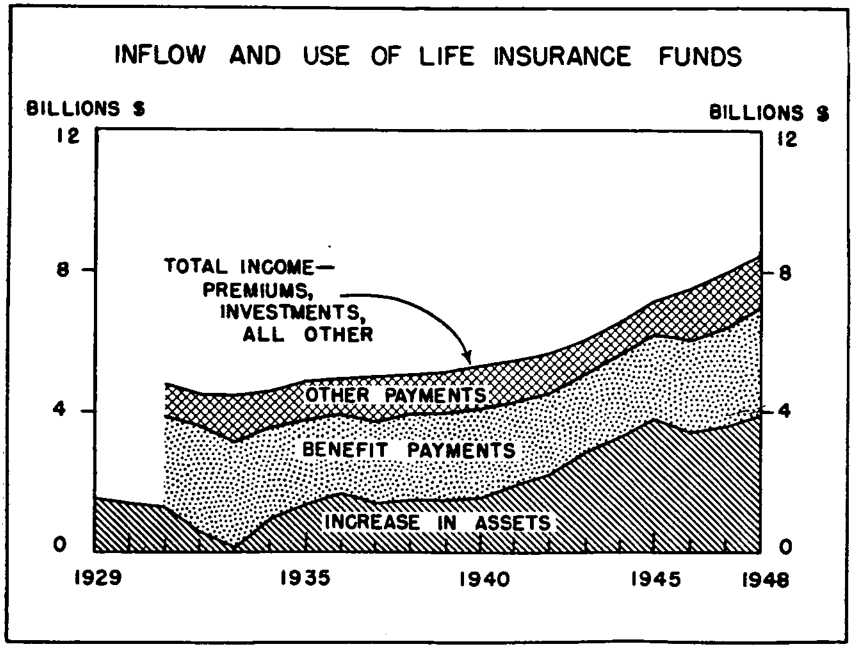


CHART III.—*Inflow and use of life insurance funds*

[In millions of dollars]

	Total income of United States companies	Change in assets of United States companies	Benefit payments of United States companies
1932	$4,486	$594	$2,999
1933	4,452	142	2,942
1934	4,578	948	2,603
1935	4,826	1,372	2,409
1936	4,908	1,658	2,289
1947	4,976	1,375	2,323
1938	5,050	1,506	2,447
1939	5,109	1,488	2,482
1940	5,278	1,559	2,514
1941	$5,465	$1,929	$2,393
1942	5,648	2,200	2,303
1943	6,024	2,835	2,237
1944	6,536	3,288	2,327
1945	7,129	3,743	2,475
1946	7,490	3,394	2,616
1947	7,936	3,552	2,823
1948	8,390	3,857	3,085

Income includes premiums (adjusted to exclude lump sums left with companies under supplementary contracts in year of benefit payment), gross investment income and all other income. Benefit payments include death claims, matured endowments, annuity payments, surrender values, policy dividends, and disability and double indemnity payments. Payments adjusted to exclude lump sums left with companies under supplementary contracts in year of benefit payment.

Source: Spectator.

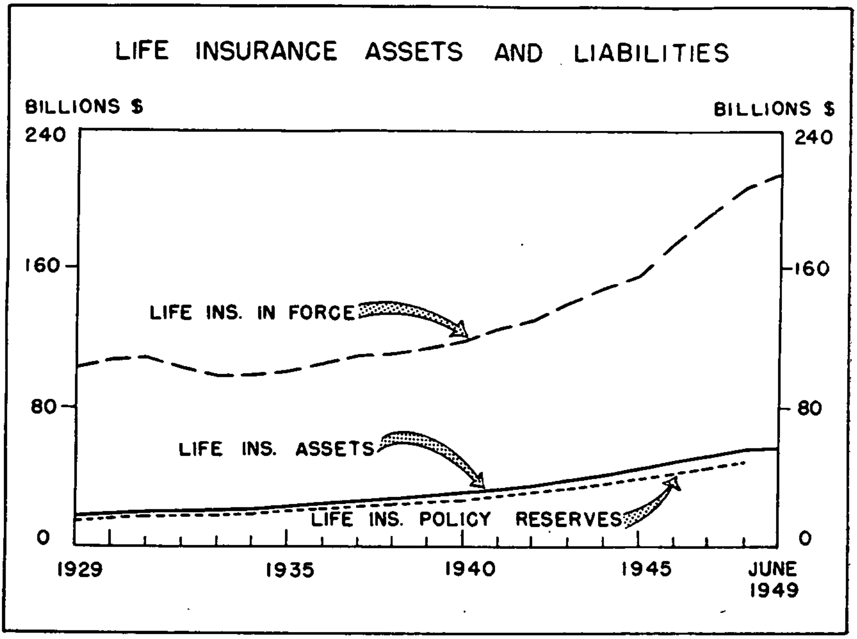
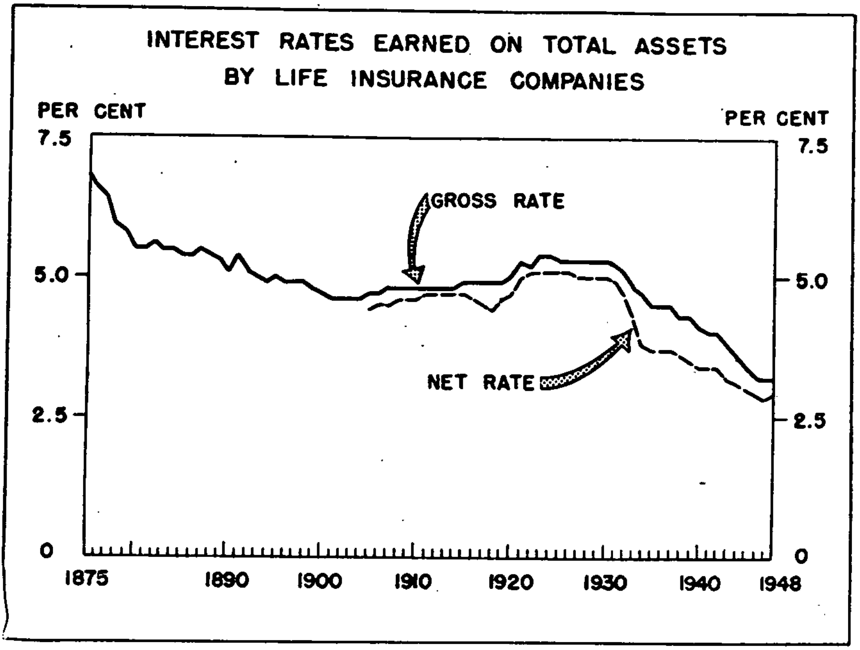


CHART IV.—*Life insurance assets and liabilities*

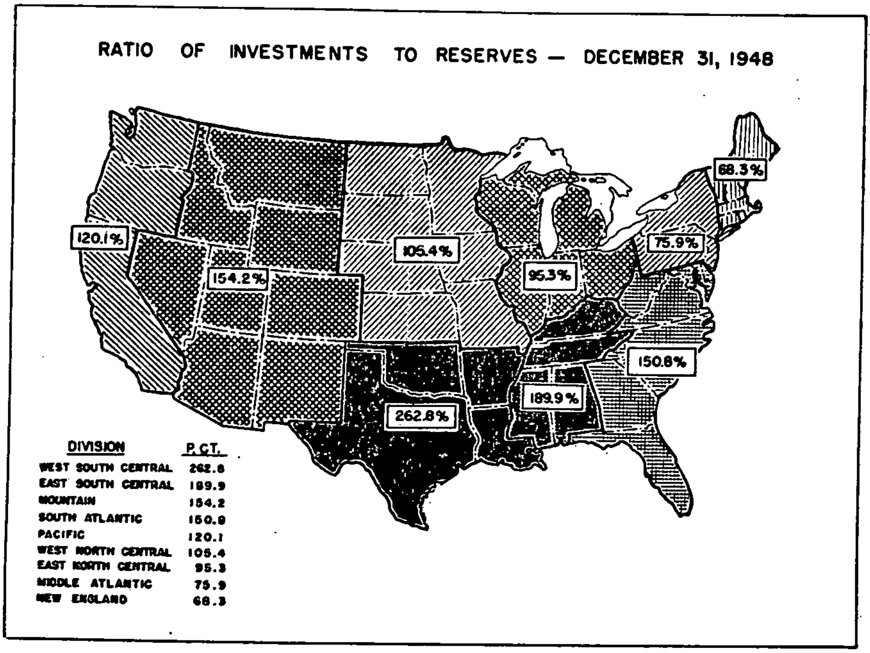
[In billions of dollars]

	Life insurance in force	Life insurance policy reserves	Life insurance company assets
1929	$103.1	$14.9	$17.5
1930	107.9	16.2	18.9
1931	108.9	17.4	20.2
1932	103.2	17.8	20.8
1933	98.0	18.1	20.9
1934	98.5	19.0	21.8
1935	100.7	20.4	23.2
1936	104.7	21.8	24.9
1937	109.6	23.2	26.2
1938	111.1	24.5	27.8
1939	114.0	25.8	29.2
1940	$117.8	$27.2	$30.8
1941	124.7	28.9	32.7
1942	130.3	30.8	34.9
1943	140.3	33.0	37.8
1944	149.1	35.6	41.1
1945	155.7	38.7	44.8
1946	174.6	41.7	48.2
1947	191.3	44.9	51.7
1948	207.1	48.2	55.6
1949 (June)	214.2		57.2

Data include all United States life insurance companies.
Data on reserves cover life, annuity, supplementary contract, disability and double indemnity reserves
Source: Institute of Life Insurance.



INTEREST RATES EARNED ON TOTAL ASSETS BY LIFE INSURANCE COMPANIES



RATIO OF INVESTMENTS TO RESERVES — DECEMBER 31, 1948

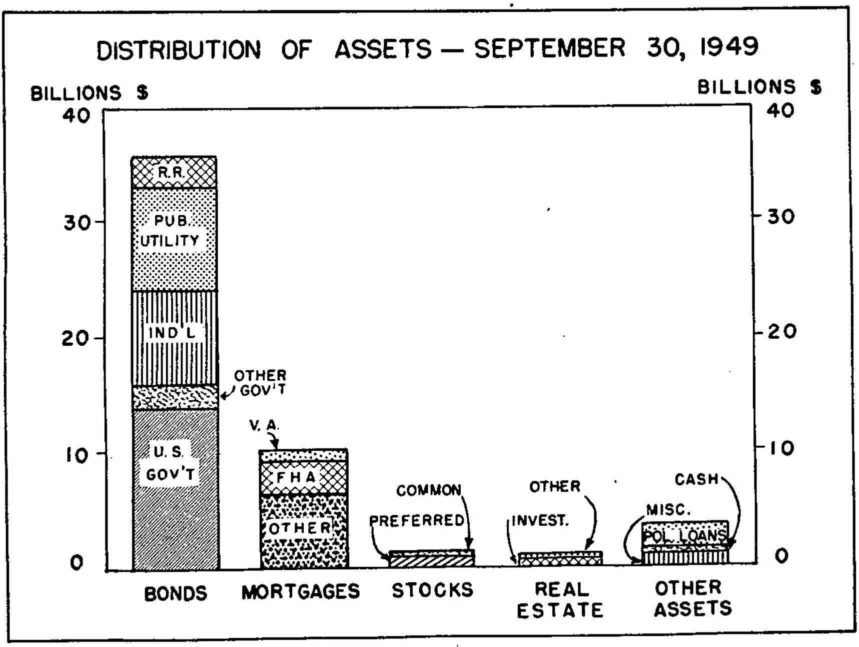
DIVISION	P.CT.
WEST SOUTH CENTRAL	262.8
EAST SOUTH CENTRAL	189.9
MOUNTAIN	154.2
SOUTH ATLANTIC	150.8
PACIFIC	120.1
WEST NORTH CENTRAL	105.4
EAST NORTH CENTRAL	95.3
MIDDLE ATLANTIC	75.9
NEW ENGLAND	68.3

CHART V.—*Interest rates earned by life insurance companies*

Year	Gross rate on total assets	Net rate on total assets	Year	Gross rate on total assets	Net rate on total assets	Year	Gross rate on total assets	Net rate on total assets
1875	6.8	----------	1900	4.7	----------	1925	5.3	5.1
1876	6.6	----------	1901	4.6	----------	1926	5.3	5.1
1877	6.4	----------	1902	4.6	----------	1927	5.3	5.0
1878	5.9	----------	1903	4.6	----------	1928	5.3	5.0
1879	5.8	----------	1904	4.6	----------	1929	5.3	5.0
1880	5.5	----------	1905	4.7	4.4	1930	5.3	5.0
1881	5.5	----------	1906	4.7	4.5	1931	5.2	4.9
1882	5.6	----------	1907	4.8	4.5	1932	5.1	4.7
1883	5.5	----------	1908	4.8	4.6	1933	4.8	4.3
1884	5.5	----------	1909	4.8	4.6	1934	4.7	3.8
1885	5.4	----------	1910	4.8	4.6	1935	4.5	3.7
1886	5.4	----------	1911	4.8	4.7	1936	4.5	3.7
1887	5.5	----------	1912	4.8	4.7	1937	4.5	3.7
1888	5.4	----------	1913	4.8	4.7	1938	4.3	3.6
1889	5.3	----------	1914	4.8	4.7	1939	4.3	3.5
1890	5.1	----------	1915	4.9	4.7	1940	4.1	3.4
1891	5.4	----------	1916	4.9	4.6	1941	4.0	3.4
1892	5.1	----------	1917	4.9	4.5	1942	4.0	3.4
1893	5.0	----------	1918	4.9	4.4	1943	3.8	3.2
1894	4.9	----------	1919	4.9	4.6	1944	3.6	3.1
1895	5.0	----------	1920	5.0	4.7	1945	3.4	3.0
1896	4.9	----------	1921	5.3	5.0	1946	3.2	2.9
1897	4.9	----------	1922	5.2	5.1	1947	3.2	2.8
1898	4.9	----------	1923	5.4	5.1	1948	[1] 3.2	2.9
1899	4.8	----------	1924	5.4	5.1			

[1] Estimated.

Source: Metropolitan Life Insurance Co.



Assets 6.6 percent greater on Sept. 30, 1949, than on Sept. 30, 1948

[Data of 49 United States legal reserve companies representing 89.1 percent of total admitted assets of all United States companies]

SUMMARY

Class	September 30, 1948		September 30, 1949		Increase 1949 over 1948	
	Amount outstanding	Percent of assets	Amount outstanding	Percent of assets	Amount	Percent
	Thousands		*Thousands*		*Thousands*	
Bonds	$34,477,690	71.0	$35,661,021	68.9	$1,183,331	3.4
Stocks	1,185,754	2.5	1,296,081	2.5	110,327	9.3
Mortgages	8,405,221	17.3	10,091,763	19.5	1,686,542	20.1
Real estate	894,978	1.8	1,058,996	2.0	164,018	18.3
Policy loans and premium notes	1,761,459	3.6	1,896,272	3.7	134,813	7.7
Cash	821,690	1.7	689,971	1.3	−131,719	−16.0
Other, less assets not admitted	1,020,280	2.1	1,094,851	2.1	74,571	7.3
Admitted assets	48,567,072	100.0	51,788,955	100.0	3,221,883	6.6
BONDS						
U. S. Government, due or callable:						
Within 1 year	$360,827	0.7	$203,549	0.4	−$157,278	−43.6
1 year or later	15,722,800	32.4	13,667,202	26.4	−2,055,598	−13.1
	16,083,627	33.1	13,870,751	26.8	−2,212,876	−13.8
State, county, and municipal	587,204	1.2	685,661	1.3	98,457	16.8
Canadian Government [1]	1,379,222	2.9	1,397,382	2.7	18,160	1.3
Other foreign governments	17,630	0	18,322	0	692	3.9
Railroad	2,720,824	5.6	2,757,663	5.3	36,839	1.4
Public utility	7,448,168	15.3	8,767,936	17.0	1,319,768	17.7
Other	6,241,015	12.9	8,163,306	15.8	1,922,291	30.8
	34,477,690	71.0	35,661,021	68.9	1,183,331	3.4
STOCKS						
Preferred:						
Railroad	$71,501	0.1	$70,919	0.1	−$582	−0.8
Public utility	258,390	.6	310,380	.6	51,990	2.0
Other	616,473	1.3	649,879	1.3	33,406	5.4
	946,364	2.0	1,031,178	2.0	84,814	9.0
Common:						
Railroad	24,799	.1	27,478	.1	2,679	10.8
Public utility	63,808	.1	67,172	.1	3,364	5.3
Other	150,783	.3	170,253	.3	19,470	12.9
	239,390	.5	264,903	.5	25,513	10.7
Total:						
Railroad	96,300	.2	98,397	.2	2,097	2.2
Public utility	322,198	.7	377,552	.7	55,354	17.2
Other	767,256	1.6	820,132	1.6	52,876	6.9
	1,185,754	2.5	1,296,081	2.5	110,327	9.3

[1] Including political subdivisions.

Assets 6.6 percent greater on Sept. 30, 1949, than on Sept. 30, 1948—Continued

MORTGAGES

Class	September 30, 1948		September 30, 1949		Increase 1949 over 1948	
	Amount outstanding	Percent of assets	Amount outstanding	Percent of assets	Amount	Percent
Farm:	*Thousands*		*Thousands*		*Thousands*	
Veterans' Administration	$23, 417	0. 0	$25, 077	0. 1	$1, 660	7. 1
Other	792, 641	1. 7	919, 317	1. 7	126, 676	16. 0
	816, 058	1. 7	944, 394	1. 8	128, 336	15. 7
Non-farm:						
Federal Housing Administration	1, 636, 399	3. 4	2, 522, 123	4. 9	885, 724	54. 1
Veterans' Administration	922, 259	1. 9	992, 057	1. 9	69, 798	7. 6
Other	5, 030, 505	10. 3	5, 633, 189	10. 9	602, 684	12. 0
	7, 589, 163	15. 6	9, 147, 369	17. 7	1, 558, 206	20: 5
Total:						
Federal Housing Administration	1, 636, 399	3. 4	2, 522, 123	4. 9	885, 724	54. 1
Veterans' Administration	945, 676	1. 9	1, 017, 134	2. 0	71, 458	7. 6
Other	5, 823, 146	12. 0	6, 552, 506	12. 6	729, 360	12. 5
	8, 405, 221	17. 3	10, 091, 763	19. 5	1, 686, 542	20. 1

REAL ESTATE

Investment:						
Residential	$226, 257	0. 4	$284, 883	0. 5	$58, 626	25. 9
Commercial	327, 716	. 7	450, 412	. 9	122, 696	37. 4
	553, 973	1. 1	735, 295	1. 4	181, 322	32. 7
Company used	223, 378	. 5	238, 430	. 5	15, 052	6. 7
Other nonfarm	65, 258	. 1	46, 945	. 1	−18, 313	−28. 1
Farm	52, 369	. 1	38, 326	. 0	−14, 043	−26. 8
	894, 978	1. 8	1, 058, 996	2. 0	164, 018	18. 3

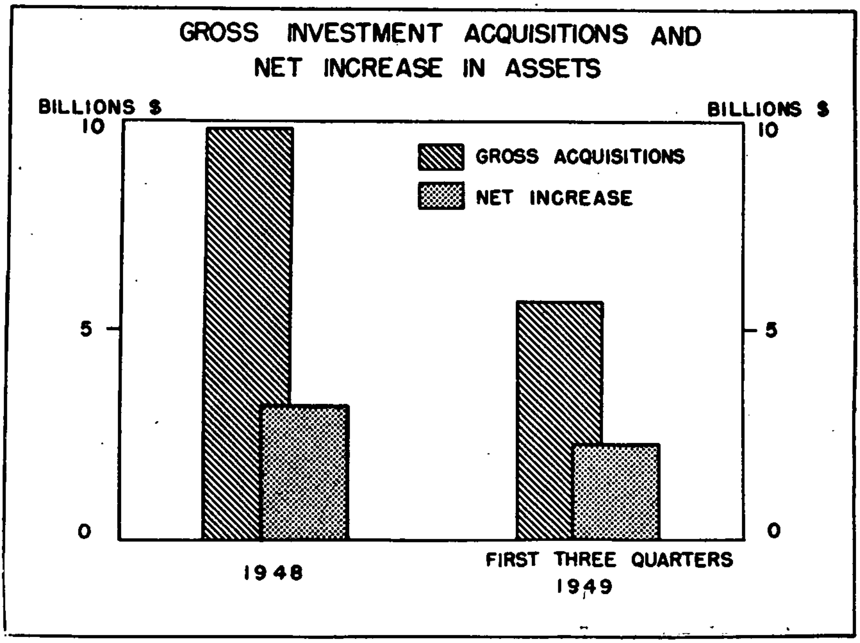


CHART VIII.—*Gross investment acquisitions and net increase in assets, 49 companies*

[Thousands of dollars]

	Year 1948	First three quarters 1949
Investments acquired	$9,835,608	$5,689,464
Net increase	3,198,814	2,265,558

Source: Life Insurance Association of America.

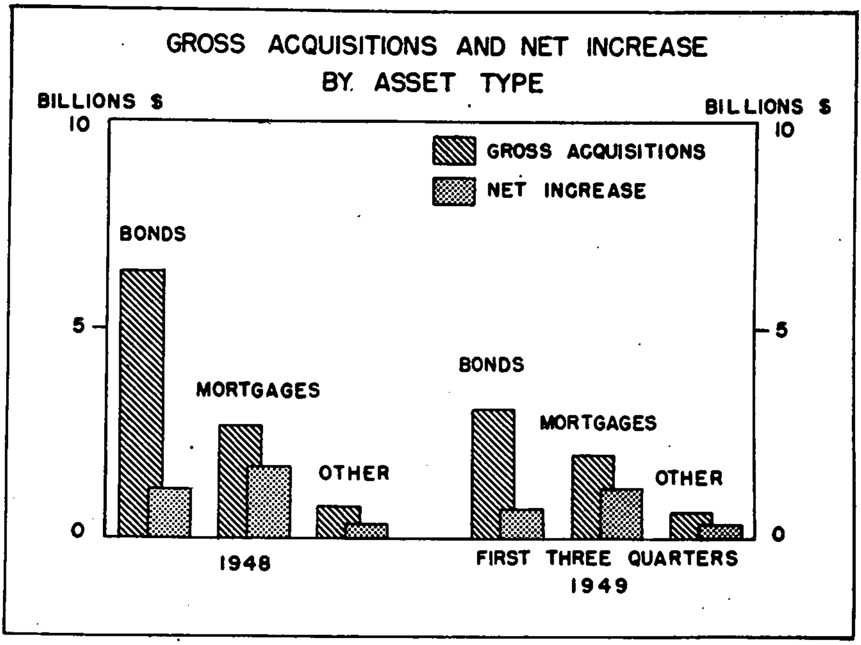


CHART IX.—*Gross acquisitions and net increase by asset type, 49 companies*

[Thousands of dollars]

	Year 1948	First three quarters 1949
Investments acquired:		
Bonds	$6,372,557	$3,089,966
Mortgages	2,714,969	1,993,642
Other	748,082	605,856
Total	9,835,608	5,689,464
Net increase:		
Bonds	1,131,185	719,842
Mortgages	1,714,376	1,198,458
Other	353,253	347,258
Total	3,198,814	2,265,558

Source: Life Insurance Association of America.

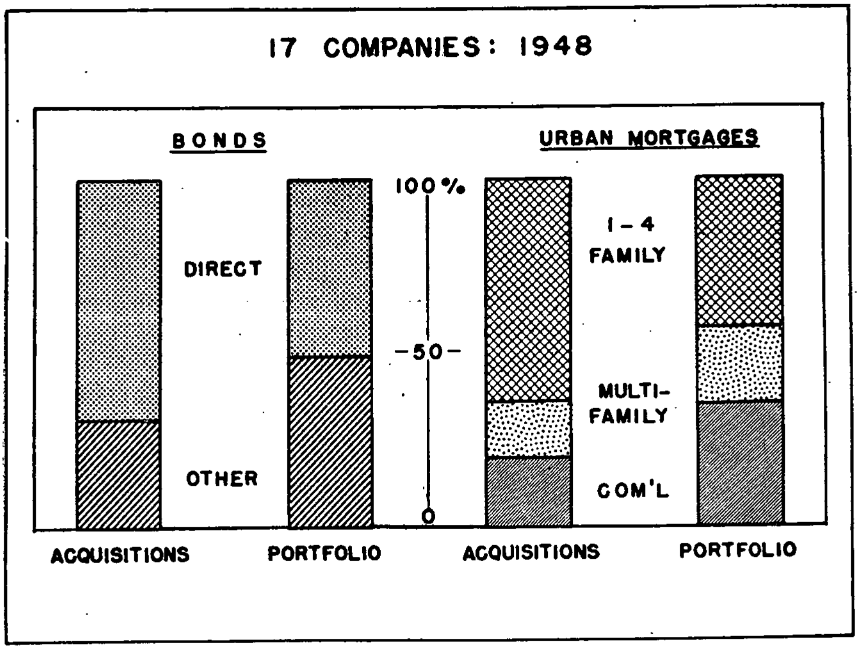


CHART X.—*17 life companies, 1948*

Type of placement	Bonds				Type of property	Urban mortgages			
	Acquired		Held Dec. 31			Acquired		Held Dec. 31	
	Million dollars	*Percent*	*Million dollars*	*Percent*		*Million dollars*	*Percent*	*Million dollars*	*Percent*
Direct	2,380	68.8	7,041	51.0	1- to 4-family	1,082	63.9	2,393	43.
Other than direct	1,078	31.2	6,756	49.0	Multifamily	273	16.1	1,218	21.
					Commercial	338	20.0	1,958	35.
Total	3,458	100.0	13,797	100.0	Total	1,693	100.0	5,569	100.

TABLE I.—*Mortgage loans to business, $25,000 or more in amount, made by 17 major United States life-insurance companies in 1948 (dollar amount and number of loans by size of loan)*[1]

Size of loan (in thousands)	Amount (in thousands)	Percent	Number of loans	Percent
Under $25				
$25 to $50	$20,300	6.13	585	29.9
$50 to $100	40,903	12.35	605	30.9
$100 to $200	48,284	14.58	363	18.5
$200 to $500	81,555	24.63	285	14.5
$500 to $1,000	46,548	14.06	69	3.5
$1,000 to $2,000	39,643	11.97	33	1.6
$2,000 to $5,000	37,906	11.45	12	.6
$5,000 to $10 000	6,000	1.81	1	.0
$10,000 to $20,000	10,000	3.02	1	.0
$20,000 to $50 000				
$50 000 to $100,000				
$100,000 to $200,000				
$200,000 and over				
Information lacking				
Total	331,141	100.00	1,954	100.0

[1] In a few instances companies which extended additional amounts to borrowers following close of yea included these amounts in size of loan.

NOTE.—Components may not add to totals because of rounding.
Source: Investment research department of the Life Insurance Association of America.

TABLE II.—*Mortgage loans to business, $25,000 or more in amount, made by 17 major United States life-insurance companies in 1948 (dollar amount and number of loans by size of obligation)*[1]

Asset size of obligor (in thousands)	Amount (in thousands)	Percent	Number of loans	Percent
Under $25	$219	0.07	7	0.36
$25 to $50	2,596	.78	80	4.09
$50 to $100	19,012	5.74	438	22.42
$100 to $200	36,563	11.04	513	26.25
$200 to $500	65,479	19.77	467	23.90
$500 to $1,000	50.246	15.17	210	10.75
$1,000 to $2,000	49,754	15.03	120	6.14
$2,000 to $5,000	51,399	15.52	65	3.33
$5,000 to $10,000	24,945	7.53	22	1.13
$10,000 to $20,000	9.578	2.89	6	.31
$20,000 to $50,000	10,150	3.07	2	.10
$50,000 to $100,000	3,600	1.09	4	.20
$100,000 to $200,000				
$200,000 and over				
Information lacking	7,590	2.29	20	1.02
Total	331,141	100.00	1,954	100.00

[1] Before financing. Where asset size of obligor was not available, net worth or value of land and buildings was used.

NOTE.—Components may not add to totals because of rounding.
Source: Investment research department of the Life Insurance Association of America.

TABLE III.—*Mortgage loans to business, $25,000 or more in amount, made by 17 major United States life-insurance companies in 1948 (dollar amounts by type of business)*

Type of business	Amount (in thousands)	Percent
Retail stores and warehouses	$152,040	45.91
Wholesale stores and warehouses	2,681	.81
Hotels, theaters, garages, etc	53.755	16.23
General office buildings	62,332	18.82
Mercantile not classified	6,964	2.10
Educational and religious	1,487	.45
Banks, insurance companies, finance	4,153	1.25
Railroad, utility and industrial	35,375	10.68
Other	12,354	3.73
Total	331,141	100.00

NOTE.—Components may not add to totals due to rounding.
Source: Investment research department of the Life Insurance Association of America.

TABLE IV.—*Mortgage loans to business, $25,000 or more in amount, made by 17 major United States life-insurance companies in 1948 (dollar amount and number of loans by geographic divisions)*

Geographic divisions (census)	Amount (in thousands)	Number of loans
New England	$25,121	171
Middle Atlantic	102,259	513
East North Central	61,448	394
West North Central	20,774	104
South Atlantic	38,355	247
East South Central	6,061	43
West South Central	30,273	107
Mountain	3,546	32
Pacific	37,296	305
Canadian, etc	6,007	38
Total	331,141	1,954

NOTE.—Dollar amounts may not add to totals because of rounding.
Source: Investment research department of the Life Insurance Association of America.

TABLE V.—*Mortgage loans to business, $25,000 or more in amount, made by 17 major United States life-insurance companies in 1948 (number of loans, by size of loan and by location)*

Size of loan (in thousands)	New England	Middle Atlantic	East North Central	West North Central	South Atlantic	East South Central	West South Central	Mountain	Pacific	Other	Total
Under $25	------	------	------	------	------	------	------	------	------	------	------
$25 to $50	40	136	104	38	83	21	29	11	109	14	585
$50 to $100	55	148	141	24	74	9	31	14	97	12	605
$100 to $200	36	105	75	21	46	8	22	2	45	3	363
$200 to $500	32	89	51	12	32	2	15	4	42	6	285
$500 to $1,000	6	20	14	4	6	1	5	1	10	2	69
$1,000 to $2,000	2	10	7	4	4	2	1	------	2	1	33
$2,000 to $5,000	------	4	2	1	2	------	3	------	------	------	12
$5,000 to $10,000	------	------	------	------	------	------	1	------	------	------	1
$10,000 to $20,000	------	1	------	------	------	------	------	------	------	------	1
Total	171	513	394	104	247	43	107	32	305	38	1,954

Source: Investment research department of the Life Insurance Association of America.

TABLE VI.—*Mortgage loans to business, $25,000 or more in amount, made by 17 major United States life-insurance companies in 1948 (dollar amounts, by size of loan and by location)*

[In thousands]

Size of loan (in thousands)	New England	Middle Atlantic	East North Central	West North Central	South Atlantic	East South Central	West South Central	Mountain	Pacific	Other	Total
Under $25	------	------	------	------	------	------	------	------	------	------	------
$25 to $50	1,412	4,712	3,681	1,357	2,805	761	1,026	368	3,699	481	20,300
$50 to $100	3,773	10,169	9,315	1,785	5,176	520	2,119	943	6,362	741	40,903
$100 to $200	4,853	13,829	9,963	2,927	5,946	1,052	3,059	235	6,010	410	48,284
$200 to $500	8,952	25,397	14,463	3,030	9,285	518	4,495	1,250	12,320	1,850	81,555
$500 to $1,000	3,590	13,896	9,810	2,975	3,622	850	3,025	750	6,505	1,525	46,548
$1,000 to $2,000	2,542	12,050	8,415	5,500	4,226	2,360	1,150	------	2,400	1,000	39,643
$2,000 to $5,000	------	12,206	5,800	3,200	7,300	------	9,400	------	------	------	37,906
$5,000 to $10,000	------	------	------	------	------	------	6,000	------	------	------	6,000
$10,000 to $20,000	------	10,000	------	------	------	------	------	------	------	------	10,000
Total	25,121	102,259	61,448	20,774	38,355	6,061	30,273	3,546	37,296	6,007	331,141

NOTE.—Components may not add to totals because of rounding.
Source: Investment research department of the Life Insurance Association of America.

TABLE VII.—*Mortgage loans to business, $25,000 or more in amount, made by 17 major United States life-insurance companies in 1948 (number of loans, by asset size of obligor and by location)*

Asset size of obligor (in thousands)	New England	Middle Atlantic	East North Central	West North Central	South Atlantic	East South Central	West South Central	Mountain	Pacific	Other	Total
Under $25	1	3	------	------	2	1	------	------	------	------	7
$25 to $50	5	27	9	1	10	2	7	1	14	4	80
$50 to $100	28	125	100	24	54	10	15	9	65	8	438
$100 to $200	49	134	114	26	66	11	18	8	81	6	513
$200 to $500	51	113	93	19	59	11	31	8	75	7	467
$500 to $1,000	29	50	37	8	29	3	11	3	32	8	210
$1,000 to $2,000	3	35	22	9	15	1	8	1	23	3	120
$2,000 to $5,000	5	16	9	6	8	3	6	1	10	1	65
$5,000 to $10,000	------	3	6	2	------	------	6	1	4	------	22
$10,000 to $20,000	------	2	1	1	2	------	------	------	------	------	6
$20,000 to $50,000	------	1	------	------	------	------	------	------	1	------	2
$50,000 to $100,000	------	1	------	1	1	1	------	------	------	------	4
Information lacking	------	3	3	7	1	------	5	------	------	1	20
Total	171	513	394	104	247	43	107	32	305	38	1,954

Source: Investment research department of the Life Insurance Association of America.

TABLE VIII.—*Mortgage loans to business, $25,000 or more in amount, made by 17 major United States life-insurance companies in 1948 (dollar amounts, by asset size of obligor and by location)*

[In thousands]

Asset size of obligor (in thousands)	New England	Middle Atlantic	East North Central	West North Central	South Atlantic	East South Central	West South Central	Mountain	Pacific	Other	Total
Under $25	35	87	------	------	65	32	------	------	------	------	219
$25 to $50	170	798	428	26	290	70	213	25	467	110	2,596
$50 to $100	1,293	5,424	4,430	939	2,531	422	694	352	2,476	463	19,022
$100 to $200	3,579	10,704	8,083	1,560	4,348	523	1,259	572	5,480	457	36,563
$200 to $500	7,634	18,943	13,526	2,962	7,582	897	3,867	1,024	8,565	480	65,479
$500 to $1,000	7,249	13,496	8,776	1,524	7,332	668	2,630	434	6,442	1,693	50,245
$1,000 to $2,000	1,570	16,871	9,806	3,625	3,175	100	3,875	325	8,852	1,555	49,754
$2,000 to $5,000	3,592	15,841	9,665	5,650	5,176	2,350	5,700	65	3,110	250	51,399
$5,000 to $10,000	------	5,045	5,530	280	------	------	11,586	750	1,754	------	24,945
$10,000 to $20,000	------	1,725	473	80	7,300	------	------	------	------	------	9,578
$20,000 to $50,000	------	10,000	------	------	------	------	------	------	150	------	10,150
$50,000 to $100,000	------	2,000	------	100	500	1,000	------	------	------	------	3,600
$100,000 to $200,000	------	------	------	------	------	------	------	------	------	------	------
Information lacking	------	1,325	730	4,028	57	------	450	------	------	1,000	7,590
Total	25,121	102,259	61,448	20,774	38,355	6,061	30,273	3,546	37,296	6,007	331,141

NOTE.—Components may not add to totals because of rounding.
Source: Investment research department of the Life Insurance Association of America.

TABLE IX.—*Direct placements of railroad, public utility, and industrial and miscellaneous bonds—1948 combined portfolios of 17 major United States life insurance companies, dollar amounts by size of obligor (cost basis)*

[In thousands of dollars]

Size of obligor [1] (in thousands)	Railroad	Public utility	Industrial and miscellaneous	Total corporate
Under $500		3,797	872	4,669
$500 to $1,000		11,071	6,439	17,511
$1,000 to $2,000	908	39,604	36,178	76,690
$2,000 to $5,000	5,039	133,064	169,318	307,420
$5,000 to $10,000	3,788	163,817	219,600	387,205
$10,000 to $20,000	426	216,906	403,369	620,700
$20,000 to $50,000	13,522	340,123	720,144	1,073,790
$50,000 to $100,000	22,118	346,390	527,277	895,785
$100,000 to $200,000	16,676	478,762	554,607	1,050,046
$200,000 to $500,000	4,018	519,119	609,173	1,132,310
$500,000 to $1,000,000	15,878	182,066	803,346	1,001,230
$1,000,000 and over	38,683	207,721	191,624	438,027
Information lacking		2,100	33,977	36,077
Total	121,055	2,644,479	4,275,925	7,041,459

[1] After financing.

NOTE.—Components may not add to totals because of rounding.
Source: Investment Research Department of the Life Insurance Association of America.

TABLE X.—*Direct placements of railroad, public utility, and industrial and miscellaneous bonds—1948 combined acquisitions of 17 major United States life-insurance companies, dollar amounts by size of obligor (cost basis)*

[In thousands of dollars]

Size of obligor [1] (in thousands)	Railroad	Public utility	Industrial and miscellaneous	Total corporate
Under $500		425	430	855
$500 to $1,000		1,056	2,023	3,079
$1,000 to $2,000		3,349	15,464	18,813
$2,000 to $5,000		21,069	67,074	88,143
$5,000 to $10,000		26,430	87,093	113,522
$10,000 to $20,000		29,730	190,646	220,377
$20,000 to $50,000		84,632	340,833	425,465
$50,000 to $100,000	6,419	94,511	183,106	284,036
$100,000 to $200,000	7,242	152,220	176,892	336,355
$200,000 to $500,000		73,899	115,457	189,356
$500,000 to $1,000,000			600,883	600,883
$1,000,000 and over			84,000	84,000
Information lacking			15,602	15,602
Total	13,661	487,320	1,879,504	2,380,485

[1] After financing.

NOTE.—Components may not add to totals because of rounding.
Source: Investment research department of the Life Insurance Association of America.

TABLE XI.—*Direct placements of railroad, public utility, and industrial and miscellaneous bonds—1948 combined portfolios of 17 major United States life-insurance companies, percent of total dollar amounts by size of obligor (cost basis)*

Size of obligor[1] (in thousands)	Percent of total			
	Railroad	Public utility	Industrial and miscellaneous	Total corporate
Under $500		0.14	0.02	0.07
$500 to $1,000		.42	.15	.25
$1,000 to $2,000	0.75	1.50	.85	1.09
$2,000 to $5,000	4.16	5.03	3.96	4.37
$5,000 to $10,000	3.13	6.19	5.14	5.50
$10,000 to $20,000	.35	8.20	9.43	8.81
$20,000 to $50,000	11.17	12.86	16.84	15.25
$50,000 to $100,000	18.27	13.10	12.33	12.72
$100,000 to $200,000	13.78	18.10	12.97	14.91
$200,000 to $500,000	3.32	19.63	14.25	16.08
$500,000 to $1,000,000	13.12	6.88	18.79	14.22
$1,000,000 and over	31.95	7.85	4.48	6.22
Information lacking		.08	.79	.51
Total	100.00	100.00	100.00	100.00

[1] After financing.

NOTE.—Components may not add to totals because of rounding.
Source: Investment Research Department of the Life Insurance Association of America.

TABLE XII.—*Other than direct placements of railroad, public utility, and industrial and miscellaneous bonds—1948 combined portfolios of 17 major United States life-insurance companies, dollar amounts by size of obligor (cost basis)*

[In thousands of dollars]

Size of obligor[1] (in thousands)	Railroad	Public utility	Industrial and miscellaneous	Total corporate
Under $500	(2)			(2)
$500 to $1,000	(2)			(2)
$1,000 to $2,000	(2)	68		(2)
$2,000 to $5,000	(2)	2,423	816	(2)
$5,000 to $10,000	(2)	7,025	5,907	(2)
$10,000 to $20,000	(2)	39,294	29,266	(2)
$20,000 to $50,000	(2)	242,240	57,332	(2)
$50,000 to $100,000	(2)	640,070	109,198	(2)
$100,000 to $200,000	(2)	823,354	133,373	(2)
$200,000 to $500,000	(2)	839,680	221,637	(2)
$500,000 to $1,000,000	(2)	437,758	108,572	(2)
$1,000,000 and over	(2)	864,669	70,362	(2)
Information lacking	(2)	17,513	2,482	(2)
Total	2,103,079	3,914,093	738,945	6,756,116

[1] After financing.
[2] Not available.

NOTE.—Components may not add to totals because of rounding.
Source: Investment Research Department, of the Life Insurance Association of America .

TABLE XIII.—*Other than direct placements of railroad, public utility, and industrial and miscellaneous bonds—1948 combined portfolios of 17 major United States life-insurance companies, percent of total dollar amounts by size of obligor (cost basis)*

Size of obligor [1] (in thousands)	Percent of total			
	Railroad	Public utility	Industrial and miscellaneous	Total corporate
Under $500	[2]			[2]
$500 to $1,000	[2]			[2]
$1,000 to $2,000	[2]	[3]		[2]
$2,000 to $5,000	[2]	0.06	0.11	[2]
$5,000 to $10,000	[2]	.18	.80	[2]
$10,000 to $20,000	[2]	1.00	3.96	[2]
$20,000 to $50,000	[2]	6.19	7.76	[2]
$50,000 to $100,000	[2]	16.35	14.78	[2]
$100,000 to $200,000	[2]	21.04	18.05	[2]
$200,000 to $500,000	[2]	21.45	29.99	[2]
$500,000 to $1,000,000	[2]	11.18	14.69	[2]
$1,000,000 and over	[2]	22.09	9.52	[2]
Information lacking	[2]	.45	.34	[2]
Total	100.00	100.00	100.00	100.00

[1] After financing.
[2] Not available.
[3] Less than 0.005 percent.

NOTE.—Components may not add to total because of rounding.
Source: Investment Research Department of the Life Insurance Association of America.

TABLE XIV.—*Direct placements of railroad, public utility, and industrial and miscellaneous bonds—1948 combined acquisitions of 17 major United States life-insurance companies, number by size of obligor*

Size of obligor [1] (In thousands)	Railroad	Public utility	Industrial and miscellaneous	Total corporate
Under $500		3	3	6
$500 to $1,000		6	5	11
$1,000 to $2,000		12	28	40
$2,000 to $5,000		41	78	119
$5,000 to $10,000		40	73	113
$10,000 to $20,000		40	93	133
$20,000 to $50,000		66	99	165
$50,000 to $100,000	1	40	41	82
$100,000 to $200,000	3	47	28	78
$200,000 to $500,000		21	18	39
$500,000 to $1,000,000		0	30	30
$1,000,000 and over		0	1	1
Information lacking		0	8	8
Total	4	316	505	825

[1] After financing.

Source: Investment Research Department of the Life Insurance Association of America.

TABLE XV.—*Direct placements of railroad, public utility, and industrial and miscellaneous bonds—1948 combined acquisitions of 17 major United States life-insurance companies, percent of total number by size of obligor*

Size of obligor [1] (in thousands)	Percent of total			
	Railroad	Public utility	Industrial and miscellaneous	Total corporate
Under $500	------------	0.95	0.59	0.73
$500 to $1,000	------------	1.90	.99	1.33
$1,000 to $2,000	------------	3.80	5.54	4.85
$2,000 to $5,000	------------	12.97	15.45	14.42
$5,000 to $10,000	------------	12.66	14.46	13.70
$10,000 to $20,000	------------	12.66	18.42	16.12
$20,000 to $50,000	------------	20.89	19.60	20.00
$50,000 to $100,000	25	12.66	8.12	9.94
$100,000 to $200,000	75	14.87	5.54	9.45
$200,000 to $500,000	------------	6.65	3.56	4.73
$500,000 to $1,000,000	------------	------------	5.94	3.64
$1,000,000 and over	------------	------------	.20	.12
Information lacking	------------	------------	1.58	.97
Total	100	100.00	100.00	100.00

[1] After financing.

NOTE.—Components may not add to totals because of rounding.
Source: Investment Research Department of the Life Insurance Association of America.

TABLE XVI.—*Direct placements of railroad, public-utility, and industrial and miscellaneous bonds—1948 combined acquisitions of 17 major United States life-insurance companies, percent of total dollar amounts by size of obligor (cost basis)*

Size of obligor [1] (in thousands)	Percent of total			
	Railroad	Public utility	Industrial and miscellaneous	Total corporate
Under $500	------------	0.09	0.02	0.04
$500 to $1,000	------------	.22	.11	.13
$1,000 to $2,000	------------	.69	.82	.79
$2,000 to $5,000	------------	4.32	3.57	3.70
$5,000 to $10,000	------------	5.42	4.63	4.77
$10,000 to $20,000	------------	6.10	10.14	9.26
$20,000 to $50,000	------------	17.37	18.13	17.87
$50,000 to $100,000	46.99	19.39	9.74	11.93
$100,000 to $200,000	53.01	31.24	9.41	14.13
$200,000 to $500,000	------------	15.16	6.14	7.95
$500,000 to $1,000,000	------------	------------	31.97	25.24
$1,000,000 and over	------------	------------	4.47	3.53
Information lacking	------------	------------	.83	.66
Total	100.00	100.00	100.00	100.00

[1] After financing.

NOTE.—Components may not add to totals because of rounding.
Source: Investment Research Department of the Life Insurance Association of America.

TABLE XVII.—*Other than direct placements of railroad, public-utility, and industrial and miscellaneous bonds—1948 combined acquisitions of 17 major United States life-insurance companies, number by size of obligor*

Size of obligor [1] (in thousands)	Railroad	Public utility	Industrial and miscellaneous	Total corporate
Under $500				
$500 to $1,000				
$1,000 to $2,000				
$2,000 to $5,000				
$5,000 to $10,000	4		1	5
$10,000 to $20,000		6	6	12
$20,000 to $50,000	8	44	20	72
$50,000 to $100,000	19	110	10	139
$100,000 to $200,000	25	171	8	204
$200,000 to $500,000	42	128	22	192
$500,000 to $1,000,000	47	33	20	100
$1,000,000 and over	23	80	5	108
Information lacking	1			1
Total	169	572	92	833

[1] After financing.

Source: Investment Research Department of the Life Insurance Association of America.

TABLE XVIII.—*Other than direct placements of railroad, public-utility, and industrial and miscellaneous bonds—1948 combined acquisitions of 17 major United States life-insurance companies, percent of total number by size of obligor*

Size of obligor [1] (in thousands)	Percent of total			
	Railroad	Public utility	Industrial and miscellaneous	Total corporate
Under $500				
$500 to $1,000				
$1,000 to $2,000				
$2,000 to $5,000				
$5,000 to $10,000	2.37		1.09	0.60
$10,000 to $20,000		1.05	6.52	1.44
$20,000 to $50,000	4.73	7.69	21.74	8.64
$50,000 to $100,000	11.24	19.23	10.87	16.69
$100,000 to $200,000	14.79	29.90	8.70	24.49
$200,000 to $500,000	24.85	22.38	23.91	23.05
$500,000 to $1,000,000	27.81	5.77	21.74	12.00
$1,000,000 and over	13.61	13.99	5.44	12.97
Information lacking	.59			.12
Total	100.00	100.00	100.00	100.00

[1] After financing.

NOTE.—Components may not add to totals because of rounding.
Source: Investment Research Department of the Life Insurance Association of America.

TABLE XIX.—*Other than direct placements of railroad, public-utility, and industrial and miscellaneous bonds—1948 combined acquisitions of 17 major United States life-insurance companies, dollar amounts by size of obligor (cost basis)*

[In thousands of dollars]

Size of obligor [1] (in thousands)	Railroad	Public utility	Industrial and miscellaneous	Total corporate
Under $500				
$500 to $1,000				
$1,000 to $2,000				
$2,000 to $5,000				
$5,000 to $10,000	1,680		90	1,770
$10,000 to $20,000		4,707	1,656	6,363
$20,000 to $50,000	5,961	42,516	8,229	56,705
$50,000 to $100,000	2,551	84,990	6,039	93,579
$100,000 to $200,000	9,651	183,705	2,474	195,830
$200,000 to $500,000	42,690	227,009	29,701	299,400
$500,000 to $1,000,000	30,135	99,842	24,946	154,922
$1,000,000 and over	18,401	243,539	7,849	269,789
Information lacking	46			46
Total	111,114	886,306	80,984	1,078,405

[1] After financing.

NOTE.—Components may not add to totals because of rounding.
Source: Investment Research Department of the Life Insurance Association of America.

TABLE XX.—*Other than direct placements of railroad, public-utility, and industrial and miscellaneous bonds—1948 combined acquisitions of 17 major United States life-insurance companies, percent of total dollar amounts by size of obligor*

Size of obligor [1] (in thousands)	Percent of total			
	Railroad	Public utility	Industrial and miscellaneous	Total corporate
Under $500				
$500 to $1,000				
$1,000 to $2,000				
$2,000 to $5,000				
$5,000 to $10,000	1.51		0.11	0.16
$10,000 to $20,000		0.53	2.05	.59
$20,000 to $50,000	5.36	4.80	10.16	5.26
$50,000 to $100,000	2.30	9.59	7.46	8.68
$100,00 to $200,000	8.69	20.73	3.06	18.16
$200,000 to $500,000	38.42	25.61	36.68	27.76
$500,000 to $1,000,000	27.12	11.26	30.80	14.37
$1,000,000 and over	16.56	27.48	9.69	25.02
Information lacking	.04			[2]
Total	100.00	100.00	100.00	100.00

[1] After financing.
[2] Less than 0.005 percent.

NOTE.—Components may not add to totals because of rounding.
Source: Investment Research Department of the Life Insurance Association of America.

Mr. HERTER. What are your probable dates of completion?

Mr. WOODWARD. You probably know that the probable date for a research project is longer than the date set. Information is coming in and will be coming in piecemeal over the next 2 years. I think within 2 years most of the information from these three projects ought to be public. If you want to discount that, you had better add 6 months.

The CHAIRMAN: That is a most interesting statement.

As a matter of fact, I was thinking as you were making your conclusion that it almost sounded like an announcement made on behalf of this committee, because we also are in search of facts. Conclusions can come afterward.

Mr. WOODWARD. That is right.

The CHAIRMAN. Now, my understanding is that you have already expended almost a half million dollars in this research project.

Mr. WOODWARD. That is right.

The CHAIRMAN. But to date you do not have any definite results that can be laid before the committee.

Mr. WOODWARD. Very little. I could give you two or three fragments, if you would like to know the kind of thing on the investment experience. For example, and this may be of some interest at the moment, among all the corporate bonds that were retired or extinguished in any way between 1900 and 1944, the bonds of the larger-sized companies tended to be called more frequently than those of the smaller-sized companies, while the bonds of the smaller-sized companies fell into default more frequently than the bonds of the larger-sized companies.

Bonds of the larger obligors generally provided higher yields after allowance for losses from default than bonds of smaller companies.

Now, we have presently, I believe, three or four volumes of statistical information, which is being analyzed.

I might say that the total volume of corporate bonds that were extinguished, retired somehow, between 1900 and 1944 contains $34,000,000,000 which were in issues of $5,000,000 or over.

Now, 20 percent, gentlemen, 20 percent of that $34,000,000,000 of corporate bond issues of $5,000,000 and more were extinguished following default. That gives some indication of the risk in the process of corporate bond investment.

These are not just bonds held by life-insurance companies. This is a census of all bonds outstanding or issued during that time, wherever held.

Those two facts may be illustrated. We will have a comprehensive study when the analysis is completed. We have only fragments at the moment.

The CHAIRMAN. You said at the outset that the rate of return is falling off.

Mr. WOODWARD. Yes, sir.

The CHAIRMAN. Now, is that true also of the aggregate return?

Mr. WOODWARD. Yes, sir.

The CHAIRMAN. Do you have any tables showing that?

Mr. WOODWARD. Yes; my chart V, I think it is—yes; my chart V and the statistics are attached to it—is the one that shows the gross rate earned on life-insurance assets from 1875 to the present and the net rate from 1905 to the present time. The gross rate in 1948 was 3.2 percent. During the twenties, as you can see from the table, that rate ruled at better than 5 percent. Running back into the last century, it was above 6 percent in the 1870's.

The CHAIRMAN. That table on chart V and the chart itself shows the rate?

Mr. WOODWARD. Yes, sir.

The CHAIRMAN. I was asking about the aggregate income.

Mr. WOODWARD. The aggregate income would have been rising during most of that time, because the assets are growing. I can give you that, I think, sir. That is in your own white book, Senator.

The CHAIRMAN. It is on page 235.

Mr. WOODWARD. Yes; you have that right there. As a matter of fact, the source of that is the same book (Life Insurance Fact Book, 1949) I was looking into and could not find it.

The CHAIRMAN. Yes.

Mr. WOODWARD. The investment income has been rising during most of the period. Well, this is investment and other, but it is preponderantly investment. It rose to a high in 1945 and it seems to have leveled in the years subsequent to 1945.

The CHAIRMAN. Premium income also is increasing and in 1948 it apparently reached its high.

Mr. WOODWARD. That is right.

The CHAIRMAN. So that while the investment rate has been leveled off, or the investment aggregate income has leveled off since 1945, the premium income has continued to increase.

Mr. WOODWARD. That is right, sir.

The CHAIRMAN. Does that mean that the increasing investment, even though it has leveled off, increasing investment return has not operated to reduce premium?

Mr. WOODWARD. Well, the investment income always operates to reduce premium in a mutual company. The investment income in excess of that required to maintain reserves is then available either for additions to surplus, if necessary, or a dividend to the policyholder.

The CHAIRMAN. To what do you attribute this decline in the gross and the net rate? That appears to have taken place since 1930 and 1931.

Mr. WOODWARD. It is during the period since the 1920's that the United States and most other countries in the world have become increasingly dedicated to cheap money as a prerequisite of economic progress. I am referring to the theories of Lord Keynes and others. We have during that period followed, well, I should think with increasing vigor, most of the time, monetary policies by Government to lower interest rates, primarily by the Federal Reserve System's operation.

I believe myself that is the predominant factor in bringing down interest rates on all investments.

The CHAIRMAN. You have not had sufficient report from this research project to give you any insight into the future as yet?

Mr. WOODWARD. No, sir.

The CHAIRMAN. I ask that because your final project, of course, is to try to find out the prospects for investment and availability of funds over the period of the future years.

Mr. WOODWARD. That is right.

The CHAIRMAN. That is included within your prospectus?

Mr. WOODWARD. That is right. I may give it as my personal opinion, for what it is worth, that we shall not have any considerable increase in interest rates for some time to come. That is my interpretation of Government monetary policy as it is operating.

The CHAIRMAN. What is your personal opinion with respect to the prospects for the availability of investment?

Mr. WOODWARD. From the standpoint of the borrower, do you mean?

The CHAIRMAN. No; from the standpoint of the loaner.

Mr. WOODWARD. I think there is no shortage of availability of investments so far. There is not entirely a satisfactory rate on those investments.

The CHAIRMAN. What would you say the 17 larger companies have to find investments for per month?

Mr. WOODWARD. Well, my total figure for 1948 for 49 leading companies was $9,800,000,000. That, divided by 12, would be about $800,000,000.

The CHAIRMAN. Do any of these companies report any difficulty in finding proper investments?

Mr. WOODWARD. Well, I cannot speak for individual companies. One hears of difficulties of finding investment, which I believe usually means investment at a satisfactory rate. As I have emphasized, the lower the rate the higher the cost of life insurance to the public, and that is a great concern of ours.

The CHAIRMAN. But, by and large, these companies do not report any difficulty of obtaining avenues in which to invest their funds?

Mr. WOODWARD. Mr. Chairman, I think the individual witnesses who are to follow me, who operate the specific company-investment affairs, can answer that.

The CHAIRMAN. Yes; each company will have a different experience, naturally.

Mr. WOODWARD. What I mean is that they are directly in the investment operation. I am in research. Mr. Whipple, financial vice president of Mutual Life, who operates the investment branch, will be before you on Friday morning; and, being in the market—that being his full-time job—he can answer that question much more competently than I can do it.

The CHAIRMAN. On your first chart, there was a striking change which took place about 1942, in that for the first time that chart shows personal income per family became greater than the life insurance in force per family.

Do you care to make any comment about the significance of that?

Mr. WOODWARD. Well, I believe, though I do not have the back figures available, that they were in the past some years, including some of the 1920's in which income exceeded life insurance per family. However, specifically to your question: What happened at that time, you recall, was war financing. And the pressure upon individuals was increasingly to put a higher proportion of their income that they could save into Government securities. So that they put more there and not as much as they might otherwise have put into life insurance.

The CHAIRMAN. I called attention the other day to the fact that, as shown by table III on page 229 of our print on Factors Affecting the Stability of Private Investment, the total amount of life insurance and the total amount in United States savings bonds, estimated for 1948, is exactly the same.

Mr. WOODWARD. That is right.

The CHAIRMAN. I also called attention to the striking figure on postal savings.

Mr. WOODWARD. Yes.

The CHAIRMAN. There you will see that there has been a much, much greater rate of increase than in any other line of savings.

Mr. WOODWARD. That is right.

The CHAIRMAN. They havê increased from 250 million dollars in 1930 to 3,430 million dollars in 1948.

Mr. WOODWARD. That is right.

The CHAIRMAN. That is slightly less than it was in 1947, when the actual figures were 3,523 million dollars.

Mr. WOODWARD. That is right.

The CHAIRMAN. You are familiar with those?

Mr. WOODWARD. Yes, sir.

The CHAIRMAN. Do you attach any particular significance to that fact?

Mr. WOODWARD. No particular significance. The explanation that I would give is entirely conjectural, and I expect we would agree on it. First, during the 1930's the impact of bank failures led many people to think that it might be desirable to put their savings in a Government institution. And later, during war financing—and this is absolutely conjectural—the post offices played a considerable part in the sale of the War Savings bonds, and I expect that perhaps people may have become a little more accustomed to going to the post office to deal with their savings. That is absolutely conjectural.

The CHAIRMAN. Well, I think without any question the fear of the stability of the banks after the depression of 1929 operated to increase the amount of postal savings.

Mr. WOODWARD. Yes.

The CHAIRMAN. But the total which was then invested in postal savings was just a fraction compared with the amount that is invested in them now.

Mr. WOODWARD. That is right.

The CHAIRMAN. But in any event it is clear that, with postal savings and savings bonds, there is a very large amount of personal savings being placed in the hands of the Government.

Mr. WOODWARD. That is right.

The CHAIRMAN. Now a substantial part of these savings bonds, of course, were sold for the express purpose of financing the war, and the holders of those bonds deliberately invested, I suppose, for that purpose. There can be no question about that.

Mr. WOODWARD. That is right.

The CHAIRMAN. Because there were country-wide drives based upon the patriotic appeal, and all that.

Mr. WOODWARD. That is right.

The CHAIRMAN. But do you attach any significance to this increase of savings bonds, Government bonds, and life insurance at the same time?

Mr. WOODWARD. May I say one thing on postal savings, and then come to your question, because there is still another factor. And that is that during these years since 1930, as you will realize, the commercial banks have reduced the rate of interest that they pay on deposits very substantially. While the mutual savings banks' rates are something like competitive with the postal savings, I think in many areas of the country where there are no mutual savings banks the commercial bank rate is somewhat under the postal savings rates, and that fact is another factor that is tending to increase postal savings.

Now to come directly to your question.

The CHAIRMAN. On that point. This table would indicate that mutual savings have doubled since 1930.

Mr. WOODWARD. Yes, sir. But you realize that mutual savings banks operate in only a few States. I think it is only 17 of the 48 States.

The CHAIRMAN. That is right.

Mr. WOODWARD. So, the balance of the States are served by the savings departments of commercial banks.

Now the broader question: The rise in the total dollars of savings is, of course, affected by the increase in the supply of money and the depreciation in the value of money that I pointed out in discussing my deflated figures.

The proportion of income that individuals are saving does not seem to have risen over this period of time. In short, these increases in savings appear to be simply a function of the rise in the incomes of the individuals.

Now, the proportion of personal income saved has fluctuated over a wide range, as my second chart shows. But, so far as I can see, it is a fluctuation without trend. It is just that things change as conditions change.

It seems to be running—if one could properly make an average, which one could not properly do because the data are so different—it seems to be running in the area of 5 or 6 percent of personal income that goes to savings.

Mr. SCOLL. And that does not change?

Mr. WOODWARD. I see no evidence that it has changed. As I say, this is such an exceedingly irregular line that I do not see yet, at least, that one can draw any trend of change.

The CHAIRMAN. May I call your attention to the map which undertook to show the geographical distribution of the ratio of investments to reserves as of December 31, 1948.

Mr. WOODWARD. Yes, sir.

The CHAIRMAN. Now, what do you mean by "reserves" there?

Mr. WOODWARD. Reserves represent all of the assets of the companies specifically held to pay future claims to policyholders, to annuitants, to any others who may have funds with the companies. Those reserves account for 48 billions out of the 55 billions of total assets.

The CHAIRMAN. I mean you are talking about the reserves which have been set aside to cover policies in the particular States that are shown?

Mr. WOODWARD. That is correct, sir.

The CHAIRMAN. So that actually this does show the ratio also, relatively speaking, between investments and policies?

Mr. WOODWARD. The reserves for those policies?

The CHAIRMAN. Yes.

Mr. WOODWARD. Yes, sir.

The CHAIRMAN. But I mean there would not be very much variation if you just were to make it on the amount of the first value of the policy; would there?

Mr. WOODWARD. It would alter the ratio very substantially.

The CHAIRMAN. It would. That is what I want to find out.

Mr. WOODWARD. Yes, because a policy that has been issued only in the last year or two would have very small reserves; a policy that has been issued for many years may have reserves equal to half of its face value. But that would probably be the extreme; that is, the reserves on the extreme, I suppose, would not be more than a half to 60 or 70 percent other than in the most exceptional cases.

The CHAIRMAN. So that this table is a very accurate presentation of the ratio between the amount which the insurance companies have set aside as reserves to pay the policies and the investments in the particular area?

Mr. WOODWARD. It is as accurate as we can make it, sir. And I believe it is accurate; yes, sir.

The CHAIRMAN. Mr. Scoll, do you want to ask some questions?

Mr. SCOLL. I do not have any questions, sir.

The CHAIRMAN. Mr. Herter?

Mr. HERTER. Yes.

I have been going over your tables from 10 on, and have become a little confused.

Mr. WOODWARD. It is quite an array of information.

Mr. HERTER. It is an array of information, but the difficulty in some cases you have combined acquisitions in a given year and in others combined portfolios.

Mr. WOODWARD. That is right. We thought you might be interested in this both ways.

Mr. HERTER. The trouble is that, the way they follow each other, they are not quite consecutive, and you have to go diving from one to the other to try to find out the corresponding relationship.

Mr. WOODWARD. I had that same trouble in putting them together. I could not decide which was the logical order.

Mr. HERTER. What I wanted to ask in connection with them was this: The direct placements versus the indirect placements, as I read these tables, show that your direct placements in the public-utility field are very much smaller than in the industrial and miscellaneous. Is that a correct interpretation?

Mr. WOODWARD. What table are you looking at, sir?

Mr. HERTER. Take table 12.

Mr. WOODWARD. Table 12 is not the direct placements.

Mr. HERTER. That is not the direct placements?

Mr. WOODWARD. That is right.

Mr. HERTER. But then you go over to the acquisition table, which is 10, and you will notice the acquisition table is for only 1 year, whereas your other is combined. And I cannot find the 1 year to correspond to table 10, unless it is table 14.

Mr. WOODWARD. You mean——

Mr. HERTER. I cannot find the corresponding table to show which of your different classifications show more direct placement. In other words, your railroad acquisitions, clearly from your tables, in the last year have been very small compared with the other investments.

Mr. WOODWARD. That is right.

Mr. HERTER. I would guess—and I am subject to correction through difficulty in following these tables—as between your public utility and your industrial and miscellaneous, while the total volume in the portfolios may run pretty equal, you have got direct placements of industrial and miscellaneous very much more frequently than you have in the public-utility field. In other words, more public-utility bonds are bought in the open market than there are through direct placement.

Mr. WOODWARD. I will answer that in just a moment, sir, when 1 get these tables straight myself.

Mr. Herter, if you will compare table 10 and table 19, I think it may be the answer.

Table 10 is the acquisitions in 1948 by direct placement. Table 19 is the other than direct acquisitions in 1948.

Mr. HERTER. Well, that carries out my point, the point I was trying to make, that I had hoped you might be able to interpret. Your industrial and miscellaneous during 1948, your direct placements, were $1,800,000,000?

Mr. WOODWARD. That is right.

Mr. HERTER. As against only $80,000,000 that were bought in the open market?

Mr. WOODWARD. Yes, sir.

Mr. HERTER. Whereas your public utilities, direct placements, were $487,000,000 as against $886,000,000 bought in the open market?

Mr. WOODWARD. That is right.

Mr. HERTER. And your railroads, $13,000,000, direct placement as against $111,000,000 bought in the open market?

Mr. WOODWARD. That is right.

Mr. HERTER. I am wondering if you could interpret the over-all policies that make for those variations in these figures.

Mr. WOODWARD. Congressman, I have participated in the collection of these figures. They represent, of course, what the specific investment men do and are thinking. I would be on much sounder ground if I told you what the figures are and asked you to ask the investment men about what they are doing.

Mr. HERTER. One other very general question: The lower the rate of your interest return, the higher the cost of insurance?

Mr. WOODWARD. Yes, sir.

Mr. HERTER. That is in the broad statement that you made?

Mr. WOODWARD. Yes, sir.

Mr. HERTER. What has been the over-all trend during this period of time for which your chart indicated that the returns had gone from 7½ down to 2.9 percent? What has been the general trend in the cost of life insurance? Has it stayed reasonably even because of the shifts in your mortality experience during that period of time, or has the actual cost gone up?

Mr. WOODWARD. Those two conflicting factors have operated.

Mr. HERTER. Have they pretty much balanced each other out?

Mr. WOODWARD. They have made for an increase in the cost of life insurance in the past 20 years in most policies, especially in those that represent the policies where the investment aspect is heavier. I do not have it prior to that; that is, prior to 1930. I have not yet got the figures worked back to answer that question.

Mr. HERTER. I am sorry, I did not get your interpretation between 1930 and today.

Mr. WOODWARD. I say from possibly 1930 to the present there appears to have been an increase in the cost of insurance for those types of contracts that involve a considerable investment element; for example, in the endowments and the limited-pay life, and that sort of thing.

I think that the term insurance, which is very little investment and very much mortality may not show any such trend. That is, to put it differently, the impact of the yield change differs on different types of insurance.

I would be glad to put a statement and some figures on that question in the record if you would like, Mr. Herter.

Mr. HERTER. Assuming that the general policy of any insurance company is to try to adjust its premium rates to assure a safe margin, with interest returns dependent upon what the market can reasonably yield as of a given time. Obviously the rates have been going down steadily?

Mr. WOODWARD. Yes, sir.

Mr. HERTER. In this shift—again this is a policy question you may not wish to answer. In this shifting emphasis from Government bonds, for instance, which has been quite marked in recent years to industrials or to utilities, have you got a break-down on the yield of the utility field, the yield of the industrial and miscellaneous as against the yield of the Government bonds?

Mr. WOODWARD. Well, I can tell you generally on that.

At present the market yield for high-grade long-term industrial and public utility bonds is in the order of 2¾ percent or less, and the yield on long Governments at the present price is down to about 2¼ percent.

Mr. HERTER. Then obviously, whether you like it or not, if your premium tables are based on 2½ percent yield, you have got to get a considerable proportion of industrial bonds to make up for the below-par yield of your Government bonds.

Mr. WOODWARD. That is correct.

Mr. HERTER. Would not it be a natural tendency for the insurance industry to shift away from Government bonds more and more with the very cheap interest rates that are being paid by the Government?

Mr. WOODWARD. That is the tendency that has been in operation; that is, there has been a movement from Governments not only to corporate securities but to mortgages, too.

Mr. HERTER. Looking at it again purely statistically, would you not say that would continue as long as we have the cheap-money policy and control policy in the Government?

Mr. WOODWARD. And so long as those alternative avenues of investment provide securities which we can take.

Mr. HERTER. There again a question comes to my mind which I do not think is quite fair to ask you, and please refuse to answer it if you wish.

As a matter of investment policy, taking, for instance, this utility block I see in here, with a very large increase in utility investment, when private placements are made in that field, is the interest rate that can be secured on those about comparable to an interest rate of similar bonds bought in the open market?

Mr. WOODWARD. I think the investment man had better answer that, sir. I can make a guess, but I am not an investor, and all the rest of the gentlemen you are going to talk to are.

Mr. HERTER. Thank you.

That is all.

The CHAIRMAN. May I ask you to return to the chart on distribution of assets as of September 30, 1949, and the supporting table?

Mr. WOODWARD. Yes, sir.

The CHAIRMAN. These questions follow those that have just been asked by Congressman Herter.

This table shows that between September 30, 1948, and September 30, 1949, there was a decrease of 13.8 in the total amount of Government bonds held by the 49 legal reserve companies, does it not?

Mr. WOODWARD. I do not see the 13 percent, sir. It shows, if we are looking at the same table, that September 30, 1948, Government bond holdings were just over $16,000,000,000, which was 33 percent of assets, and on September 30, 1949, they were just under $14,000,000,000, which was 26.8 percent.

The CHAIRMAN. And then the third column, which seems to be labeled "Increase."

Mr. WOODWARD. Yes, sir; I am sorry; the decline in dollar amount of 13.8 percent is shown; yes, sir.

The CHAIRMAN. In other words, during that year the 49 legal reserves sold $2,212,876,000 of Governments?

Mr. WOODWARD. Yes, sir.

The CHAIRMAN. United States Governments.

But during the same period State, county, and municipals were increased by 16.8 percent?

Mr. WOODWARD. Yes, sir .

The CHAIRMAN. Any significance in that? Of course there is not nearly as many.

Mr. WOODWARD. Not nearly.

The States, counties and municipalities were held back from making a large volume of improvements during the war just as private business was, indeed, and are coming into the market now to procure funds to make good those shortages.

Furthermore, as you know, there are quite a variety of bonds issued to obtain funds to pay bonuses to veterans of the individual States. So that the amount of State, local, and municipal bonds coming out is on the rise at the present time.

The CHAIRMAN. Canadian governments increased by 1.3 percent. Other foreign governments increased 3.9 percent. That, of course, was a very insignificant figure.

Mr. WOODWARD. That is right.

The CHAIRMAN. As against the total assets of the companies.

Railroads increased 1.4 percent and public utilities increased 17.7 percent, while other bonds—which I take would be chiefly industrials?

Mr. WOODWARD. That is right.

The CHAIRMAN. Increased by 30.8 percent.

Mr. WOODWARD. That is right.

The CHAIRMAN. Would it be proper to infer from that that there was a very much better outlook for industrials in that year than previously?

Mr. WOODWARD. I think you would find that trend having prevailed for the past 2 or 3 years, not only just for this year. I do not have the figures immediately here, but the answer is "Yes," industrial companies are concerned with making up the plant and equipment that they had to defer during the war, and also are adapting themselves to the new technological processes that have become available. And the utility companies, of course, are moving as fast as they can to be sure that we do not run into a power shortage as the public is using more and more power.

The CHAIRMAN. The chart itself for which this table is supporting information would indicate that bonds are far and away the principal source of investment, of course.

Mr. WOODWARD. Yes.

The CHAIRMAN. What is the third from the bottom? You have United States Governments, other governments, and "ind'l."

Mr. WOODWARD. That means industrial.

The CHAIRMAN. That is the industrial loan?

Mr. WOODWARD. The "other government" is the other than United States Government.

The CHAIRMAN. I understand what that is. So that comparatively speaking these other categories of investment bonds, stock, real estate, and other assets are very much less important than the bonds, United States Government?

Mr. WOODWARD. The answer is "Yes," but with this qualification: that the mortgages are the largest single block there other than United States Governments, that is, the mortgages are larger than either utility or industrial.

The CHAIRMAN. Now if you will return to the chart entitled "Inflow and Use of Life Insurance Funds"?

Mr. WOODWARD. Yes, sir.

The CHAIRMAN. That would seem to indicate that in the period from 1933 on there has been a steady increase of the assets of the insurance companies.

Mr. WOODWARD. Yes, sir.

The CHAIRMAN. And the other premiums, that is, payments outside of benefit payments, have increased only slightly. Am I right?

Mr. WOODWARD. Yes, sir.

The CHAIRMAN. And benefit payments have not increased materially?

Mr. WOODWARD. Yes, sir.

The CHAIRMAN. Chart III, supporting that, recites that in 1932 benefit payments of United States companies amounted to $2,999,000,000.

Mr. WOODWARD. 1932?

The CHAIRMAN. Right.

Mr. WOODWARD. Yes, sir.

The CHAIRMAN. And if you will observe, it is not until we get down to 1948 that those payments have exceeded three billion.

Mr. WOODWARD. Yes, sir.

The CHAIRMAN. So that the figure on benefit payments by these insurance companies has been very stable from 1932 through 1948?

Mr. WOODWARD. Yes, sir.

The CHAIRMAN. And very little variation. In 1932, $2,999,000,000; and then in succeeding years it fell off as low as $2,303,000,000, about 1942, and then it went up again.

Now, compare it with that table entitled "Change in Assets of United States Companies."

Mr. WOODWARD. Yes, sir.

The CHAIRMAN. In 1932 the admitted assets amounted to $594,000,000. In 1933 there was a tremendous drop there. Is that figure correct—142?

Mr. WOODWARD. Yes, sir. You see that was in the worst of the depression.

The CHAIRMAN. That is right. I did not know that the fall was as great as that shows.

Mr. WOODWARD. That is still an increase, you see. It is just a smaller increase.

The CHAIRMAN. Yes. Now then, the increase for the next year, in 1934, was $948,000,000. Then we find it growing at a really remarkable rate until in 1948 the addition was $3,857,000,000. Is that right?

Mr. WOODWARD. Yes, sir.

The CHAIRMAN. Now the total income of the companies has more than doubled—no, not quite doubled—since 1932. In 1932, $4,486,000,000; in 1948, $8,390,000,000.

Mr. WOODWARD. Yes, sir.

The CHAIRMAN. Now, is there any special explanation for the fact that although the total income of the companies has increased at a very remarkable rate and the assets have grown at a very remarkable rate, the benefit payments remain practically stable?

Mr. WOODWARD. Yes, sir.

This is going to be a little complicated. The reason for that, sir, primarily, is that as I have shown the benefit payments here they are payments made to policyholders and their beneficiaries.

Now a considerable proportion of life insurance policies that become payable at the death of the insured are actually left with the company to pay out in installments to the beneficiary—a hundred dollars a month, or something—for the rest of her life.

There is a growing practice for policyholders to stipulate in their policy that the funds will be left with the company to be paid out gradually to the beneficiaries instead of being paid as a lump sum to a widow who may not know how to handle the funds.

I can provide for the record the detailed figures showing the extent to which that is true. And it is that reason that accounts for the much more rapid increase in assets than in benefit payments.

The CHAIRMAN. Well, do I then understand that you mean since 1932 there has been a substantial increase in the number of installment payments of benefits as compared with what the practice was in the early days, and that there are many fewer lump-sum payments now than there were in the old days?

Mr. WOODWARD. That is correct, sir.

The CHAIRMAN. That is the distinction you want to make?

Mr. WOODWARD. That is the distinction. Now, the figures are sometimes shown both ways.

The CHAIRMAN. Why do you not prepare a column to be inserted here which would show the amount of benefit payments that accrued for each year?

Mr. WOODWARD. Yes, sir.

The CHAIRMAN. That would be a different figure; would it?

Mr. WOODWARD. That would be a different figure; yes, sir.

The CHAIRMAN. I think unless you do that this increase of assets and increase of income is totally out of proportion.

Mr. WOODWARD. You are quite correct, sir. It does need the explanation.

The CHAIRMAN. And I really would like to know what the comparison is between accruals and increased assets and increased income.

Mr. WOODWARD. We will give you a statement covering that.

The CHAIRMAN. Then the first chart which shows the comparison of life insurance in force per family and personal income per family would indicate that the increase in life insurance in force from 1929 at $3,300 to 1948 at $4,800 has been an increase of only $1,500?

Mr. WOODWARD. Yes, sir.

The CHAIRMAN. Have you any figures showing the maximum and minimum policies? To have an average of $3,300 for 1929 and an average of $4,800 for 1948 there must be a large number of very small policies.

Mr. WOODWARD. There is great diversity; yes, sir.

The CHAIRMAN. Do you have a chart showing the amount of outstanding policies according to the face value of the policies, number and amount?

Mr. WOODWARD. I do not have it with me. I am not sure that is available, but we will get and provide to you what we can on that.

The CHAIRMAN. I should think it would be easy to do that.

Mr. WOODWARD. I know we have some break-down. Whether it is as full as that you have specified, I am not sure.

The CHAIRMAN. I think you have given us a very great deal of information in the figures that are here.

Mr. HERTER. Mr. Chairman, may I ask a question?

The CHAIRMAN. Mr. Herter.

Mr. HERTER. I was wondering, in connection with the statistical work, if you had included the large number of smaller companies, would you have felt there would have been any material change in these over-all figures? In other words, is there a tendency on the part of the smaller companies to have a different ratio of investments than in the larger companies, or would it show pretty equal, do you think, for the entire industry?

Mr. WOODWARD. No; there are undoubtedly some great differences. And I believe that you are going to have in the next few days witnesses who will bring out some of those differences. After all, we are talking now about 500 companies scattered around the country, and they do not all follow the same policy. You will find some that are higher in one thing and lower in another thing, and I am sure that the average size loan made, the distribution by size, will inevitably be smaller for the smaller companies.

Mr. HERTER. One other question. In connection with a question that has been raised at various times, when these direct placements are made and there is a substantial investment in the industrial concern, the insurance companies try to protect themselves without getting into the actual management of the concern itself, the one in which they have invested. What is the general practice from the point of view of investment bankers when they make these offerings? Is it to make an offering which is split among a number of insurance companies, or do the insurance companies usually take the entire offering as it comes from a given industrial concern?

Mr. WOODWARD. Both practices are followed. I think the specific investment officers, again, can tell you more about that. But I have observed that sometimes they are taken by one company, sometimes they are split among a number of companies, and sometimes, as Mr. Ecker or Mr. Lincoln was describing this morning, banks may be in, particularly on the shorter end of the obligation.

Mr. Herter. I missed that this morning.

Mr. Woodward. I do not have any figures on that, but I know that all three of those things do happen.

The Chairman. Congressman Buchanan, have you any questions?

Mr. Buchanan. These questions involve real estate investment. And I just wondered whether you cared to comment on the approaches as far as statutory limitations are concerned, or whether you would rather have that put off.

Mr. Woodward. I think the specific investment officers could probably handle that better than I. I am a research man and I do not get into those specific questions. I know, of course, different States have different requirements.

Mr. Buchanan. The same in regard to the Housing Act of 1949 in relation to public housing bonds or investment bonds?

Mr. Woodward. I just do not know the answer to that question, sir; I am sorry. I am sure these investment officers will be prepared to take that up.

Mr. Buchanan. Thank you.

The Chairman. Mr. Scoll?

Mr. Scoll. Mr. Woodward, you have dealt extensively with commercial loans, $25,000 or more, and you have some tables, I believe, tables 1 to 8?

Mr. Woodward. Yes, sir.

Mr. Scoll. Do you happen to know what the proceeds of any of those loans are used for, whether they are used to pay debts or establish new ventures, or for any other purposes?

Mr. Woodward. My belief is that if we had the facts we would find all those things there. I do not have them for the industry. I believe that some of the individual companies may have something on that from their own figures.

Mr. Scoll. You speak of reinvestment of payments. Much of that is refunding rather than investment, what might be termed "new capital investment," is it not?

Mr. Woodward. You mean the difference between the gross acquisitions and the net increase?

Mr. Scoll. Yes.

Mr. Woodward. Yes; refunding is in there. And in the years when the interest rate was falling fast there was a very great deal of it, indeed.

Mr. Scoll. Much of it was refunding?

Mr. Woodward. That is right. And we may be in the beginning of another one of those, the interest rate having fallen this year. There has been some rise in refunding in these last few months.

Mr. Scoll. You have no over-all figures for indicating new capital investment in the form of life insurance investment as against refunding or repayment of obligation? Do you have any generalization you would care to make on that point?

Mr. WOODWARD. I do not. I believe that Mr. Whipple has some specific figures for the Mutual Life when he comes on. I do not have any for the industry basis.

The CHAIRMAN. Any other questions?

Mr. Woodward, may I ask this question: Does this new research bureau send out questionnaires?

Mr. WOODWARD. I do not think we have sent out any questionnaires yet except within our own business.

The CHAIRMAN. Just in your business.

Mr. WOODWARD. Yes.

The CHAIRMAN. I just wondered whether you had the same experience that sometimes the committees of Congress have in sending out questionnaires.

Mr. WOODWARD. I am sure we will if we do.

The CHAIRMAN. Because I am afraid, now that the companies are employing economists, that they may be indoctrinated into the art of preparation and issuing questionnaires.

Mr. WOODWARD. We are looking for facts, sir.

The CHAIRMAN. And that is the only way I know to get them.

Mr. WOODWARD. As a matter of fact, you know, Senator, I am also engaged in some research activity in the sales end of the business, about why policyholders do what. And among the public there is no such resistance to answering questionnaires as the conversation would seem to indicate. We find we can go and ask individuals questionnaires that run for a half an hour to an hour and there is no resistance of any appreciable amount, and they will keep the interviewer on to continue to talk about their problems.

(Discussion off the record.)

The CHAIRMAN. I think it might be worth while, since we are discussing questionnaires, to make note that the first reference to questionnaires that I have run across in this country was in a letter from George Washington to a man in Scotland congratulating him because he had started issuing questionnaires to obtain some social information with respect to business or welfare in Scotland. George Washington thought it would be a pretty good idea to follow.

Were there any other questions?

The witnesses tomorrow will be Mr. Dwight L. Clarke, president of the Occidental Life Insurance Co., of California; Mr. Joseph M. Bryan, first vice president of the Jefferson Standard Life Insurance Co.; and in the afternoon, Mr. Devereaux C. Josephs, president of the New York Life Insurance Co.

Before we close the record, let me express our appreciation, Mr. Woodward, for this great volume of valuable information which you have given us. I think it is safe to say that you have presented us a lot of information that has never been made public before. I am inclined to think that we are profiting by the TNEC.

The committee will stand in recess until 10 o'clock tomorrow morning.

(Whereupon, at 4:15 p. m., the subcommittee adjourned, to reconvene at 10 a. m. Thursday, December 8, 1949.)

(Additional information requested of Mr. Woodward at various points during his testimony has been supplied as follows:)

II

Congressman Herter inquired (p. 22) regarding the trend over a period of years of the cost of life insurance. This information for several different policy types and ages at issue is as follows:

Average, 19 companies—20-year average net cost

	Age 25		Age 35		Age 45	
	Policy continued	Policy surrendered	Policy continued	Policy surrendered	Policy continued	Policy surrendered
Whole-life policy [1] of $1,000:						
1. Actual history 1908–28	$15.16	$3.85	$20.10	$3.96	$28.64	$6.81
2. Actual history 1928–48	14.68	3.29	20.24	4.03	29.92	8.03
20-year-endowment policy of $1,000:						
1. Actual history 1908–28	37.32	12.68	38.58	−11.42	42.00	−8.00
2. Actual history 1928–48	41.19	−8.86	42.49	−7.56	46.26	−3.78

[1] Whole-life policy or comparable plan.

NOTE.—In the endowment policy the cash value after 20 years exceeds the cost, resulting in a negative cost or a return in excess of cost if the policy is surrendered.

Average for 8 companies—Nonparticipating premium rates for term policy of $1,000

	Age 25	Age 35	Age 45
5-year convertible term (4 companies): [1]			
1928	$8.31	$9.31	$12.77
1948	6.65	8.13	13.17
Dollar change	−1.66	−1.18	+0.40
10-year convertible term (4 companies):			
1928	8.34	9.65	13.93
1948	6.51	8.33	14.63
Dollar change	−1.83	−1.32	+0.70

[1] In the case of 2 companies the rate includes disability waiver of premium.

1. On the whole life policy a comparison of the actual history for 1928–48 with the actual history of 1908–28 shows a reduction in cost at age 25, where the effect if improved mortality is most pronounced and outweighs the decline in the interest rate, approximately no change at age 35, and an increase in cost at age 45, where the improved mortality is less important and inadequate to offset the decline in the interest rate.

2. In the endowment policy the rate of interest is much more significant than mortality, and an increase occurred at all ages, only slightly larger at the higher ages.

3. Costs on term policies are not available in the same form, and the actual premium rates on nonparticipating policies are given for eight companies. There is a sharp decline in actual premium rates quoted from 1928 to 1948 at age 25, where the improvement in mortality is large, and a smaller but considerable decline at age 35. There is a small increase at age 45. Since interest is not a factor, these term rates show a downward tendency in cost, in contrast with the endowment policy where interest is the most important factor and the cost trend is upward.

III

Senator O'Mahoney asked (p. 237) if a break-down of life insurance policies outstanding, by size, could be obtained. Such information is not available. The range by size is certainly very great. The best information that I can obtain by inquiry is that probably the largest single policy ever issued was for $1,000,000, which was issued during the 1920's, and that the smallest is probably something less than $50. The Life Insurance Fact Book 1949, published by the Institute of Life Insurance, shows that in 1948 the average size policy in force by United States life insurance companies was $2,170 for ordinary life, $1,830 for individual certificates under group life, and $290 for industrial policies, or an average for all three of $1,070.

For ordinary life policies, a break-down by size is available on a sample basis, covering policies sold in May of 1942 and May of 1949, excluding juvenile. In each of these two sample periods, the majority of policies sold were for amounts of less than $5,000. The data are on the following page.

Size distribution of ordinary life policies sold, adult policies only

	Number of policies	
	1942	1949
	Percent	*Percent*
Under $1,000	2.2	0.3
$1,000 to $1,999	55.6	33.8
$2,000 to $2,999	17.0	17.7
$3,000 to $4,999	5.5	8.6
$5,000 to $9,999	15.2	25.1
$10,000 to $24,999	3.9	12.3
$25,000 and over	0.6	2.2
Total	100.0	100.0

NOTE.—Data based on a sample of policies sold in May of each year, including ordinary sales of both ordinary and combination companies, excluding juvenile policies (ages 0 to 14), and excluding group, wholesale or industrial. Coverage of policies under $1,000 is probably inadequate.

Source: Life Insurance Agency Management Association—1942 Buyer, and unpublished material for 1949 Buyer.

But these policy sizes are not very significant from an economic standpoint. Individuals buy life insurance piecemeal as they progress through life, and many—I would guess the majority—have more than one policy. Accordingly, it may be more significant to look at the distribution of premiums paid by families. Information obtained in connection with the Survey of Consumer Finances for the Federal Reserve Board in 1948 showed that the great majority of families paying life-insurance premiums paid less than $200 per year. This information is as follows:

Distribution of amount of annual premiums by family in 1948

Amount of premiums:	*Percent of families*
0	3
$1 to $49	19
$50 to $99	19
$100 to $199	22
$200 to $499	11
$500 to $999	2
$1,000 and over	1
Not reported	2
Total percent of families covered by life insurance	79
Not covered by insurance	21
Total	100

IV

Senator O'Mahoney asked to see benefit payments to policyholders and beneficiaries on an incurred basis. The following table shows sources and uses of life-insurance-company funds, excluding investment turn-over, for those companies tabulated by Spectator Year Book, which, though a different number of companies from year to year, always includes the preponderant part of the industry. Line 7 shows benefit payments on an incurred basis, and the subsequent five lines show the break-down of this total. We are providing the entire table in order that benefit payments can be shown in the perspective of the entire company operation. For accounting reasons line 17 shows the increase in ledger assets instead of total admitted assets, as shown in chart IV of the testimony, but the difference between ledger assets and admitted assets is small, consisting of a number of minor items.

Sources and uses of life insurance company funds (excluding investment turn-over)

[In millions of dollars]

Line No.		1932	1933	1934	1935	1936	1937	1938	1939	1940	1941	1942	1943	1944	1945	1946	1947	1948
	SOURCES																	
1	Premium income excluding supplementary contracts	3, 495	3, 311	3, 507	3, 673	3, 656	3, 730	3, 761	3, 776	3, 887	4, 020	4, 121	4, 357	4, 793	5, 159	5, 626	6, 088	6, 478
2	Premium income including supplementary contracts	3, 663	3, 481	3, 716	3, 920	3, 929	4, 011	4, 068	4, 120	4, 267	4, 410	4, 503	4, 775	5, 267	5, 704	6, 204	6, 696	7, 129
3	Less considerations for supplementary contracts	168	170	209	247	273	281	307	344	380	390	382	418	474	545	578	608	651
4	Other income	991	1, 142	1, 071	1, 153	1, 251	1, 245	1, 289	1, 333	1, 391	1, 446	1, 527	1, 667	1, 743	1, 969	1. 864	2, 285	2, 474
5	Total	4, 486	4, 452	4, 578	4, 826	4, 908	4, 976	5, 050	5, 109	5, 278	5, 465	5, 648	6, 024	6, 536	7, 129	7, 490	8, 374	8, 952
	USES																	
6	Benefit payments made	2, 999	2, 942	2. 603	2, 409	2, 289	2, 323	2, 447	2, 482	2, 514	2, 393	2, 303	2, 237	2, 327	2, 475	2, 616	2, 823	3, 085
7	Benefit payments "incurred basis"	3, 087	3, 016	2, 705	2, 535	2, 429	2, 437	2, 578	2, 642	2, 681	2, 550	2, 443	2, 407	2, 528	2, 719	2, 848	3, 045	3, 308
8	Death benefits	905	877	875	877	919	937	934	943	977	990	993	1, 092	1, 203	1, 282	1, 274	1, 336	1, 443
9	Matured endowments	123	121	129	145	154	155	176	242	275	264	268	325	361	414	405	416	436
10	Surrender values	1, 346	1, 357	1, 078	883	713	669	771	732	688	573	454	295	235	241	327	390	473
11	Annuity and disability payments	150	162	185	206	225	240	250	269	284	293	294	285	291	310	335	336	355
12	Policy dividends	563	499	438	424	418	435	447	457	456	430	434	410	438	472	507	567	601
13	Net payments on supplementary contracts	−89	−74	−103	−127	−141	−114	−131	−160	−167	−157	−141	−170	−200	−244	−232	−222	−224
14	Payments on supplementary contracts	79	96	106	120	132	167	176	184	213	233	241	248	274	301	346	386	427
15	Less considerations for supplementary contracts	168	170	209	247	273	281	307	344	380	390	382	418	474	545	578	608	651
16	Other uses and expenses	833	884	931	1, 012	1, 021	1, 116	1, 071	1, 183	1, 223	1, 265	1, 185	1, 132	1, 159	1. 074	1, 463	1, 984	2, 070
17	Increase in ledger assets	655	627	1, 044	1, 405	1, 598	1, 538	1, 533	1, 444	1, 540	1, 807	2, 160	2, 655	3, 049	3, 579	3, 411	3, 567	3, 798
18	Total	4, 486	4, 452	4, 578	4, 826	4, 908	4, 976	5, 050	5, 109	5, 278	5, 465	5, 648	6, 024	6, 536	7, 129	7, 490	8, 374	8, 952

NOTE.—Items may not add to totals shown due to rounding.

Source: Spectator Insurance Year Book.

DESCRIPTION OF DATA BY LINE NUMBER

Line No.	Description
1	Includes all premium income except consideration for supplementary contracts. Prior to 1947 a few companies include accident and health premiums in Spectator, but not as a separate item. Therefore, some of these are included in line 1 for those years (the sum total of these is believed to be small). Equals line 2 less line 3.
2	Same as line 1 with considerations for supplementary contracts included.
3	Considerations received for supplementary contracts, both those involving and those not involving life contingencies.
4	Includes investment income and other receipts. Accident and health premiums are included for 1947 and 1948. They are given as a separate item in Spectator for those 2 years while for prior years they are excluded for practically all companies except where lumped with other premium items.
5	Total income excluding considerations for supplementary contracts. Equals line 1 plus line 4. The 1947 and 1948 figures in this line differ from those given in chart III entitled "Inflow and Use of Life Insurance Funds." For both 1947 and 1948 accident and health funds are included here, but excluded in chart III. 1948 also differs because of minor items.
6	Includes all benefit payments (lines 8 through 12), except accident and health benefits, plus net payments on supplementary contracts. Prior to 1947 a few companies included accident and health benefits in their statements in Spectator under other benefit payment items, so they are included here under those categories. However, this amount is not very large. Equals line 7 plus line 13.
13	Payments on supplementary contracts less considerations for supplementary contracts, life and no life contingencies. Equals line 14 less line 15.
15	Same as line 3.
16	Includes management expenses, accident and health benefits (1947 and 1948 only), net write-downs of book value of ledger assets, and miscellaneous disbursements.
17	This equals the increase in ledger assets using identical companies for both year beginning and year end. It therefore excludes any increase or decrease resulting from a change in the number of companies reporting to Spectator for the end of each year. In 1933 this increase differs appreciably from the increase in admitted assets originally presented to the committee (chart III) because it includes reinsurance of a substantial amount of assets of other companies. Line 4 also reflects such reinsurance.
18	Same as line 5. Equals sum of lines 6, 16, and 17

V

In the discussion, Senator O'Mahoney requested an explanation of the reason why assets have increased at a significant rate from 1932 to 1948, as shown in chart III, while benefit payments, shown in the same chart, remained relatively constant during a large part of the period.

The table on the preceding page on sources and uses of life insurance company funds shows a part of the reason. Line 10 shows that surrender values were decreasing during a large part of the time; this is a favorable development reflecting the increase in income of policyholders which permitted maintenance of more insurance in force. It will be seen that death benefits (line 8), matured endowments (line 9), and annuity and disability payments (line 11), all rose extensively during the period. In fact, it will be observed that the sum of these three types of payments almost doubled during the period in question.

In the discussion at that point I explained that a part of the reason for the more rapid rise in assets than in benefit payments also resulted from the fact that, to an increasing degree, the proceeds of maturing policies are left with the companies to be paid to beneficiaries on some type of installment basis. This table shows the amounts of proceeds of maturing policies that are left with the companies to purchase these supplementary contracts (lines 3 and 15). These amounts can be seen to have been rising rapidly during the period. While payments to beneficiaries from these proceeds left with the companies have been rising (line 14), they have been less to an increasing degree than the considerations received for supplementary contracts so that the net of the supplementary contract operation (line 13) is a mounting minus figure.

A variety of factors have exerted themselves during the period of time from 1932 to 1948 to cause the apparently disproportionate rise in assets of the companies compared with the benefit payments. An exhaustive discussion of these factors would require a treatise, but some of the more important ones may be summarized as follows:

1. The drop in the amount paid out in the form of surrender values: This is shown in line 10 of the table where it may be seen that during the depression years surrender payments were roughly three times their present level. This drop has a twofold effect on the proportion of benefit payments to total assets. First, it tends to offset the doubling of the contractual benefit payments previously mentioned, and second, it keeps business in force, with the supporting assets in the hands of the life-insurance companies.

2. The increasing tendency to leave funds with the companies, taking payments in the form of installments: this factor I stressed at some length in my testimony—perhaps to the extent of overemphasizing it. In addition to the settlement of death benefits and maturity values in installment payments, there is an increasing tendency for policyholders to leave dividends with the companies on deposit or to purchase additional insurance, and to pay substantial amounts of premiums in advance—thereby increasing company assets.

3. Improvement in life insurance mortality: this improvement also has a twofold effect on the comparison. Without this improvement the increase in the death benefits shown in line 9 would have been materially greater, and there would have been a corresponding reduction in the growth of assets.

4. Growth of new business: the life-insurance company assets rose from 20.2 billion dollars at the end of 1931 to 55.6 billion dollars at the end of 1948, as shown in chart IV. As the chart also shows, during this same period of time, the total life insurance in force has increased from 108.9 billion to 207.1 billion dollars at the end of 1948. This increase has been due to new business in sufficient volume to more than offset the surrenders and other terminations during the depression years. On such new business the assets tend to grow first, the peak of the benefit payments being deferred beyond the range of the present tables and charts. Furthermore, there was a very large volume of new business written during the decade pıior to 1932 and also a very large growth in the total insurance in force. These factors also contributed to the growth of assets in the succeeding years in relation to the benefit payments.

5. Reserve strengthening and surplus strengthening: the companies have found it necessary within the last decade to strengthen policy and contract reserves due to the drop in the interest rate and due to the increasing longevity of annuitants and beneficiaries of settlement options. The companies have also, in general, built up their general contingency funds and surpluses over this period of time in order to take a more realistic view of the possibilities of future asset losses, a continuance of the drop in the interest rate, and a rise in expenses of operation due to postwar inflationary trends. Such funds, incidentally, are not large in relation to the assets and liabilities which they are designed to protect, constituting an amount equal to only about 7 percent of assets—and this happens to be quite comparable with the proportion of such funds in the banking structure.

VOLUME AND STABILITY OF PRIVATE INVESTMENT

THURSDAY, DECEMBER 8, 1949

Congress of the United States,
Joint Committee on the Economic Report,
Subcommittee on Investment,
Washington, D. C.

The subcommittee met, pursuant to adjournment, at 10:15 a. m., in the caucus room, Senate Office Building, Senator Joseph C. O'Mahoney (chairman) presiding.

Present: Senator O'Mahoney (chairman), and Representative Herter.

Also present: David Scoll, special counsel to the committee.

The Chairman. The committee is in session.

Mr. Clarke, we are going to have the pleasure of having your analysis of your problems today.

STATEMENT OF DWIGHT L. CLARKE, PRESIDENT, OCCIDENTAL LIFE INSURANCE CO. OF CALIFORNIA, LOS ANGELES, CALIF.

Mr. Clarke. Thank you Senator.

I have prepared a statement here which will take me about 20 minutes to read, if that is agreeable to you.

The Chairman. Very agreeable, indeed.

Mr. Clarke. Mr. Chairman and gentlemen, in preparing this statement wherever I have included answers to the questions propounded in your joint committee's booklet entitled "Factors Affecting Volume and Stability of Private Investment," pages 213 and 214, I have identified the question referred to by parenthetical reference to its number on those pages of the joint committee's booklet.

The officers responsible for a life-insurance company's investments must always keep in mind two objectives: (1) Safety of the funds they are managing; (2) realization of an over-all interest yield sufficient to meet the contractual interest requirements of their reserves.

The Chairman. Let me interrupt you there to suggest that perhaps this statement of yours might be preceded by a little discussion of your company and its headquarters and such. I want to make it clear that we have a witness from Los Angeles this morning.

Mr. Clarke. I see. Well, being a director of the Los Angeles Chamber of Commerce, of course, I am glad to seize that opportunity.

The Chairman. I was rather surprised a Californian would pass it up until it had been called to his attention.

Mr. Clarke. Yes; and also a native Californian.

The Chairman. I did not mean to have too much.

The Witness. No; I will use restraint.

Our company is a California corporation incorporated in 1906. Its head office is in Los Angeles.

I have on the second page of my material a summary of its present asset condition. I do not know just what other information you would like.

The Chairman. It is incorporated under the laws of what State?

Mr. Clarke. Incorporated under the laws of California and, therefore, acting under the provisions of the California Insurance Code. That code is quite an elaborate instrument.

The Chairman. Somewhat different from the New York code?

Mr. Clarke. It is different quite a bit from the New York code in many particulars, similar in some. But, of course, it is strikingly different on matters like common stock, and some other matters of the type of sales contracts, agency contracts, that the company may enter into. The New York code is somewhat unique in that particular, and the California code differs from it widely.

Are there any other points?

The Chairman. That is all, thank you.

Mr. Clarke. The two points I was making about the responsibility of the officers, Mr. Chairman, is the safety of the funds they are managing, and realization of an over-all interest yield sufficient to meet the contractual interest requirements of their reserves.

In ascribing equal importance to these two objectives, one has only to point out that safety alone is not enough to insure a company's solvency. A long-continued failure to earn the amount of interest required to maintain reserves can ultimately undermine a company's solvency just as surely as losses of principal sustained through poor investments. Too great liquidity of assets, therefore, can be not only unnecessary—because of the long cycles incident to the life-insurance business—but actually dangerous.

As of September 30, 1949, the admitted assets of the Occidental Life Insurance Co. of California consisted of the following principal investment components—stated in round figures and omitting numerous items incidental to insurance accounting:

Cash and due from banks	$3, 600, 000
Home office real estate	2, 600, 000
Real estate held for investment	4, 500, 000
Real estate mortgages	127, 400, 000
Policy loans	8, 500, 000
Bonds	44, 600, 000
Common stocks	18, 500, 000
Preferred stocks	3, 500, 000
The admitted assets of two management funds	8, 000, 000
The company's net admitted assets on the above date totaled	233, 600, 000

It will be noted that our company favors a relatively larger portfolio of regularly amortized mortgage loans and a smaller aggregate of bonds than is usual with the typical company. The yield on such mortgages has exceeded that of our bond portfolio, and our experience convinces us that this increased return has been realized at no sacrifice of safety or of the degree of liquidity necessary to a life-insurance company.

May I point out that since January 1, 1930, our company has invested in mortgage loans to a total of $247,596,978, and as of September 30, last, they totaled $127,491,454. In the intervening years repayments aggregating $120,105,524 were made us. It is important to remember that this block of mortgage loans has steadily increased, from only $7,057,863 on January 1, 1930, to over $127,000,000 as of September 30, last. The only reason we could safely invest such a large proportion of our assets in these loans is because without exception they provide for regular amortization, the vast majority on a monthly basis. A relatively few farm loans call for annual installments of principal; $98,564,846 of these loans, or 77.3 percent of the total are on urban residential properties of from one to not over four family units. Of these residential loans $54,258,935 are FHA mortgages, both title II and VI but mainly the former. The properties subject to our mortgages are located in nearly every State and province wherein the company is licensed.

We also do business in Canada, as well as some of the States of the United States.

To indicate the liquidity of this mortgage portfolio, may I point out that principal repayments in 1948 totaled $16,716,352 and for the first 9 months of the present year, $14,330,863.

While a life insurance company's direct obligations to its policyholders and beneficiaries are payable in fixed dollars, its operations entail numerous disbursements that are closely related to changing cost levels and price indices, such as salaries, rents, and many other expense items. The demand upon its gross income may therefore vary greatly from year to year, quite apart from fluctuations in mortality, policy loans, and surrender values. One of the surest ways to mitigate the violence of such fluctuations is through a portfolio of common stocks where investment in same is permitted by the State of domicile, as in California. On September 30, last, our company had $18,500,000 invested in common stocks of 96 corporations—of which 48 consisted of industrial and mercantile concerns, 26 banks, 9 fire and casualty insurance companies, 8 public utilities. and 5 railroads.

On over-all review of our company's experience with common stocks in the 20 years that they have formed a part of our portfolio may be of interest.

The first common stock purchased was a nominal amount acquired during 1929. At the end of that year the book value of same was $254,752, or about 1.25 percent of the then total assets of the company.

From that year 1929 down to October 31, 1949, common stocks in 220 separate corporations have been acquired. In categories they were 139 industrials; 46 banks, casualty and fire and other financial institutions; 23 public utilities; 12 railroads.

The total amount invested during the period in all these issues was $36,470,670.04.

Down to October 31, 1949, stocks had been sold from this portfolio to the extent of almost exactly one-half of the total book value, namely, $18,108,140.04, leaving still on hand as of the latter date stocks with a book value of $18,362,530—this is slightly less than the September 30 figure previously mentioned, as some sales were made during October, but no purchases.

The amounts actually received for the stocks having a book value of $18,108,140.04 totaled $20,091,652.38, profits realized being $3,284,736.63 and losses $1,301,224.20, leaving the company a net profit on the $18,108,140.04 of $1,983,512.34, or 10.95 percent thereon in addition to dividends.

If desired, I can give you these profit-and-loss figures for each of the several categories of common stocks above mentioned, also the totals of each year's activity and the data on each individual issue of the 220 owned at any time.

Parenthetically, you may be interested in the comparative record afforded by our company's bond portfolio in the same period. Using the bonds held on January 1, 1929, as a base and adding all later acquisitions down to October 31, 1949, purchases totaled $176,863,938.98. Sales for a book value of $133,324,365.13 have been made in the interim. With due allowance for reductions by amortization of $229,106.37, this left us on October 31, 1949, with bonds having a book value of $43,310,467.48. Profits on bonds sold totaled $3,127,666.80, losses $1,125,608.91, or a net profit of $2,002,057.89. The bonds remaining in the portfolio on October 31 last had an appreciation over book value of $444,526, or a total of profits realized plus appreciation in value of $2,446,583.89.

The Chairman. Did you compute the percent of profit on the sales?

Mr. Clarke. No; I have not done that.

The Chairman. You did that for the stocks, but not for the bonds?

Mr. Clarke. Yes; I was making this more or less as a parenthetical reference. I can do it, but I have not yet.

The Chairman. It can be figured from this?

Mr. Clarke. Yes. I will submit the rates for the record.

(The material referred to is as follows:)

	Percent
For period Jan. 1, 1929, to Sept. 30, 1949:	
Average rate of interest earned	3.166303
Net profit realized on sales	.817647
Net appreciation unrealized at Sept. 30, 1949	.137943
Net rate of earning on bonds	4.121893

Mr. Clarke. In calculating the above profit-and-loss figures, I want to make clear that for a presentation such as this it seemed proper to use not merely our own company's realized profit-and-loss items but also all losses on our bonds absorbed by the corporation that owns Occidental's capital stock, even though our life company had been paid its book value in the cases of a number of defaulted bond issues in the thirties.

Reverting to dividends on our stocks, these have totaled $7,475,383.34 from 1929 down to October 31, 1949. This is at the rate of 5.2485 percent on the mean amount invested in common stocks during each of the years covered by this survey.

May I reassemble the figures in another way?

Total dividends received $7,475,383.34, or on the mean amount invested each year 5.2485 percent.

Net profit realized on stocks sold, $1,983,512.34, or an additional yield of 1.3926 percent on the mean amount invested each year.

In addition we have to consider a net appreciation on the remaining stocks held over their original book value. That figure as of October 31, 1949, was $1,732,752, which in turn represents a yield of 1.2165 percent on the mean of the amounts invested each year.

The Chairman. The figure of $1,732,752 was not realized?

Mr. Clarke. That is not realized; that is only a book figure.

Adding these three items, two of them actual dividends and profits already realized, we arrive at a total of $11,191,647.68.

These three figures represent a total yield of 7.8577 percent on the mean amount invested in common stocks each year.

The CHAIRMAN. Actually you ought to deduct $1,732,752 from that figure in the dollar column, and you ought to deduct 1.2165 percent?

Mr. CLARKE. To show actual, that is right. I thought I would put it in both ways so it would be apparent.

The CHAIRMAN. Of course, you clearly define it.

Mr. CLARKE. Yes. Frankness compels one to recognize the widespread opposition to the investment of life insurance funds in common stocks. That sentiment finds expression in the insurance laws of many of our States which do not permit companies domiciled therein to make such investments. Having recognized this, may I add some observations both as to the reasons for the opposition and as to ways in which the same might be diminished.

I cannot think of a better way to prove that generalizations are dangerous than to include all common stocks in any single assertion concerning them. Obviously they are of infinite variety and range from a most conservative investment stock with a record of unbroken dividends for maybe generations to the veriest wildcat quoted at $10 bid last week and 1 cent asked today. How inaccurate and unfair it is to attempt any blanket treatment of such unlike units. Your own committee's staff has recognized this in the observation:

> The annals of corporate finance abound with instances where bondholders and preferred stockholders in actual fact assumed fully as much or even more risk than did common stockholders. As investment media such senior securities have shown investment results in terms of amount and regularity of income and preservation of principal by no means superior to those obtained from a well-diversified list of common stocks. (Footnote on p. 106 of the booklet you have issued.)

I believe almost any practical investment manager will agree with that statement. Nevertheless any sizable bond portfolio contains obscure and wholly unmarketable items carried at their book or amortized value merely because they bear the sacred name "bond" and are backed by the presumptive evidence of good credit character afforded by the financial statement of the debtor corporation.

The most widely held common stock in the land with the finest record of management, stable earnings and dividends and enjoying preeminence in an essential industry, if admitted at all in the statement of assets, must be value at its December 31 quotation. That quotation may have been for a nominal number of shares or for many thousands. In many jurisdictions such a stock simply may not appear at all in the statement.

In questioning whether this prejudice is wholly justified and can never be overcome by appropriate State legislation, I am reminded of other investment prejudices within my own experience. About 14 years ago a few of our companies, especially our own, had begun to make FHA mortgage loans. We were skeptical at first of 80-percent loans with 20-year maturities so we picked and checked with much care. Our experience proving favorable, we increased our totals and became bolder as to terms. About that time a senior officer of a large and very reputable life insurance company exhibited disapproval of our lending money on any FHA loans—"We don't consider them a proper investment for a life insurance company," he told me sorrowfully. Within 5 years his company had become one of the most active makers of FHA loans. It still is.

I can think of safeguards on both sides of the problem that should make it easier for companies to include common stocks among their investments. One of the most cogent points raised against them arises from the present method of valuation required by the various State insurance departments. All common stocks are valued in the annual convention statements at their market price on December 31, in accordance with the annual valuation book issued by the National Association of Insurance Commissioners. December 31 in any given year may be the peak day of a wild boom; it may be the botttom of a sharp depression. Nevertheless, any stock's quotation on that one day is all that counts in determining its place in a life insurance company's portfolio.

Several improvements on that method suggest themselves. One is the average price through the year or during some other stipulated period; another is the book value adjusted to the rate of dividends earned and paid so long as the same are maintained over a designated period. Still another might be the value at which the dividends received would yield a certain rate of interest—either the rate required to maintain reserves for the particular company or the average yield on the company's assets or some similar factor.

Whatever one's preference, it does seem that a more equitable means of valuation than the present one could be employed without any sacrifice of security to policyholders. Almost any observer will admit the lack of a broad market for many of the bond issues appearing in the average portfolio. Under existing regulations most of them are permitted to be carried at their amortized book value regardless of their market value. Certainly for the best, well-seasoned common stocks, is it unreasonable to suggest some comparable treatment in the matter of valuation? If the everpresent threat of a sharp reduction of an insurer's assets and the resultant drain upon its surplus could be so removed, I believe much of the opposition to a reasonable amount of common stocks in life portfolios would disappear.

On the other hand, a statute making common stocks eligible for investment should be very much more acceptable to critics and objectors if hedged about with limitations both as to the totals that may be held and as to the maximum percentage any insurer might own in a given corporation. Some of the requirements suggested by a conservative investment policy are that only those stocks be purchased that are listed, say, on the New York Stock Exchange and that possess a record of unbroken dividends—earned as well as paid—for at least 10 years prior to the purchase as well as stocks of banks, insurance companies—other than the purchaser itself—and other financial institutions that are not commonly listed on any exchange but have a record of unbroken dividends—earned as well as paid—for at least 15 years prior to such purchase.

I certainly believe that common stocks that would meet these or similar standards and that might be bought within the limitations stated, and thereafter valued according to one of the revised methods above suggested, would stand comparison with the average unlisted bond in any company's portfolio.

With increasing frequency one finds reference by both political and financial commentators to the fact that the great aggregation of public savings entrusted to the life insurance business is preventing a needed flow of funds into equity financing. At the last annual meeting of the American Life Convention several speakers touched on this topic. None of them proposed that our funds should be diverted into this channel but they recognized the growing criticism of our business in some quarters because we refrain from supplying equity capital.

One speaker, Stahrl Edmunds, economic analyst of the Northwestern National Life Insurance Co., discussed this topic at considerable length. Very properly Mr. Edmunds by way of defense mentioned other conditions that tend to circumscribe the amount of money available for common stock investment. I agree with his thought that the correction of some of them would do more to remove possible grounds for complaint than would a change of policy by the life insurance business.

We must sit down and give considerable weight to the present discriminatory double taxation of corporate profits when passed on as dividends to stockholders. Related to it is the heavy taxation of capital profits—a most effective deterrent to risk-taking, as well as the limitations upon the taxpayer's right to carry over losses from one year to another.

One point that I do not recall Mr. Edmunds made should be stressed. In all the agitation to broaden the field for venture capital via life insurance funds, there has usually been the implied thought that there is not enough capital available for new enterprises, the development of new processes and so on. I question whether any of these critics really seriously propose that our business should embark even modestly on the financing of new and untried undertakings, large or small. The record of private enterprise shows too high a mortality among newly formed corporations. For every original investment in Ford Motor Co., for example, the individual safe deposit boxes of the land could speak eloquently of scores, maybe hundreds, of brave new ventures that died aborning with a total loss devolving upon the enterprising investor. No, even though some method may be found whereby life insurance funds may ultimately be invested in common stocks on a broader basis than at present, the financing of new ventures can never form a portion of our investment policy. No institutional class, such as life insurance policyholders, can in the very nature of their composition be expected to venture on this unreliable ground. Life insurance should only be interested in the stock of this new enterprise when it has served its credit apprenticeship and is entitled to a place on a list of seasoned stocks.

Life insurance's part in supplying capital for really new ventures could only be an indirect one. The entrepreneur willing to risk a part of his capital in a new enterprise commonly finds his surest source of funds in pledging or selling bonds or some of his listed stockholdings that command a fairly ready market. If life insurance is present as a regular buyer of such stocks, the certainty and the ease of his embarking on the new venture might be increased. The thinness of the current stock market has excited widespread comment and some apprehension. While it is no argument for life insurance purchasing common stock, the presence of our business as a regular buyer for investment to any appreciable extent would naturally make for a broader market.

In any search for further capital funds to support our economy we have to recognize that many economists are exhibiting apprehension about the ever-increasing flow of funds into fixed obligations. Not only life-insurance reserves, but the rapidly mounting pension funds of the country are yearly competing in ever keener degree for safe investment at a satisfactory return. It is fundamental that any debt structure must have an adequate capital or equity base to support it. Therefore, the present trend could in time bring about an unstable equilibrium if debt is to increase indefinitely while the equity base remains fairly stationary. As one of the largest reservoirs of the Nation's savings, the institution of life insurance cannot remain oblivious to the implications of this situation.

Assuming for the sake of argument that certain States that now bar investments in common stocks should enact liberalizing statutes, I feel the record of our American life-insurance companies assures us that they can be safely trusted to invest and supervise such holdings with due skill and prudence. They are ever mindful that well over 90 percent of any investment is directly derived from the policyholder's own reserves or cash values. Therefore, his is the primary interest to be served and satisfied.

Time and experience might be required to remove prejudices or objections to the investment of any appreciable part of their reserves in common stocks on the part of some buyers of new insurance.

In that event and maybe regardless of whether such buyer opposition were encountered, thought might be given by our business to the issuance of some new form of insurance whereunder the policyholder, while possessing traditional life insurance protection, would elect whether the investment portion of his premiums should be invested as under present limitations or, also, include common stocks in its content. This does not seem the proper place to develop this idea in detail, but I mention it as a possibility to be explored. Certainly, a business that has found within itself the immense opportunities to serve the insuring public as well as the needs of our dynamic economy in the fashion that is the proud achievement of American life insurance can successfully encompass this latest task if it is found desirable.

Thank you.

The CHAIRMAN. Mr. Clarke, in the course of your statement I observed a reference to the corporation that owns Occidental's capital stock. What is that?

Mr. CLARKE. That is the Transamerica Corp., which owns all of the stock of the Occidental Life Insurance Co.

The CHAIRMAN. So Occidental is actually a subsidiary of Transamerica?

Mr. CLARKE. That is right.

The CHAIRMAN. In what other business is this Transamerica engaged?

Mr. CLARKE. Transamerica owns stock of a fire-insurance company, of an automobile insurance company. It owns numerous blocks of stock in various banks, some industrial concerns, one mortgage and installment loan company. It has quite a numerous list of subsidiaries. Occidental is one of the largest.

The CHAIRMAN. In what State is it incorporated?

Mr. CLARKE. Transamerica Corp. is a Delaware corporation but its principal place of business is San Francisco, Calif.

The CHAIRMAN. Does it operate throughout the country?

Mr. CLARKE. It does not operate very much as a direct matter. It is nearly entirely a holding company, and its subsidiaries are not wholly confined to the West, but quite a preponderance of their interests are on the Pacific coast.

The CHAIRMAN. Did I understand you to say that it is a holding company wholly?

Mr. CLARKE. I think it would be so classified.

The CHAIRMAN. Do the officers and directors of Transamerica take part in the management of Occidental or in any of the other subsidiaries?

Mr. CLARKE. There are representatives among them on the board. Take our own board of Occidental, I think there are now two—offhand I can think of only two directors who are directors of Transamerica. We have a board of, I think, 10 or 11 members. We have one vacancy now. We have 11 members and only 2 of them are officers or directors of Transamerica.

The CHAIRMAN. Well, is Occidental autonomous, so to speak?

Mr. CLARKE. To a very surprising degree. Naturally there are major matters of policy at times that our parent company naturally has to be consulted on and voices an interest in. But to a very large degree our operations are conducted very independently.

The CHAIRMAN. All the stock of Occidental is owned by Transamerica?

Mr. CLARKE. That is right.

The CHAIRMAN. Does California law require directors to be stockholders?

Mr. CLARKE. No, it does not, if your bylaws do not require it.

The CHAIRMAN. How many stockholders in Transamerica?

Mr. CLARKE. The last figure I saw was something like, I think, nine-million-odd. It is a very large number. Excuse me, I am thinking of the number of shares. I want to correct that; I am answering you wrongly there. I think the last figure I saw was somewhere around 220,000 or 225,000, something like that.

The CHAIRMAN. Are they scattered throughout the United States?

Mr. CLARKE. They are scattered very widely.

The CHAIRMAN. Is there any large block of ownership?

Mr. CLARKE. No; I do not think there is any real heavy concentration anywhere.

The CHAIRMAN. Is Transamerica affiliated with any other corporate entity?

Mr. CLARKE. No; I do not think so.

The CHAIRMAN. Where would you say the control of Transamerica lies?

Mr. CLARKE. Of course, I am neither a director nor an officer or stockholder—well, I am a stockholder of Transamerica, but I am neither a director nor officer, and I do not know that I am a very competent witness on that point.

Of course, Transamerica was one of the corporate family that was originated by the late A. P. Giannini. Although he was a comparatively small stockholder, his influence and leadership, prestige and so on, were recognized to a degree that as long as he lived I would say he was very decidedly the controlling factor. And a lot of that has descended to his son, L. M. Giannini. I think that is psychological rather than legalistic control.

The CHAIRMAN. You will pardon me for this diversion. We are here to study investment and not corporate structure, but it was a very interesting point to me.

Mr. CLARKE. Yes.

The CHAIRMAN. You have placed the weight of your discussion on the problem of investment in common stock. I take it it would be generally agreed that the reason why State laws require and in the past have required investment in bonds rather than common stocks was because it was the feeling that bonds were more secure than common stocks.

Mr. CLARKE. That is right.

The CHAIRMAN. That bonds theoretically, at least, were supported by mortgages upon physical property or tangible assets. So that the principal, or at least a substantial amount of the principal, could be recovered even in the case of failure of the company itself. And that on the other hand, common stocks represented the risk-taking investment of owners who were willing to take a chance in the hope of making large profits.

I take it that your argument is that now a large number of common stocks have attained security. We hear a great deal of that word "security" in these days.

But the argument for the investment of the trust funds of insurance companies in common stocks rests firmly upon the basis that in some companies, at least, a degree of security has been attained so that the risk has been taken out of the common stock and the preferred stocks; is that not right?

Mr. CLARKE. Substantially; yes.

I would not say, Senator, there is a large number of common stocks. I would say there is a fairly select list. If you went through all the issues listed on the New York Stock Exchange, I certainly would pick only the minority that I would want to put funds of my company in if I were the only person passing on it.

The CHAIRMAN. But you suggested a modification of the laws to permit investment in stocks listed on the New York Stock Exchange.

Mr. CLARKE. But provided they had an unbroken dividend record, et cetera, et cetera. There would be a lot of provisos there. I would be very selective.

The CHAIRMAN. Do you think that selection should be left to the companies themselves or the standards of selection should be definitely fixed in the law?

Mr. CLARKE. I would favor enough legislation to form a pattern much as I have indicated in my statement—unbroken record of dividends not only paid but earned as well as paid, because there is a big distinction; and a listing in the case of industrials, and so on; and then in the case of stocks that are not ordinarily listed, such as I described, banks and so on, also an even longer unbroken record of dividends earned as well as paid. I think a pattern such as that and then some over-all limitations on the amount of money that could be invested in any individual stock by one life insurer, and presumably some limitation on the total amount that could be invested.

I think legislation could encompass those points. Beyond that I believe it should be the duty and right of management to select and to analyze.

The CHAIRMAN. Then within certain over-all standards of care, the largest possible amount of freedom should be allowed to the managers of a particular company?

Mr. CLARKE. I believe that is essential.

The CHAIRMAN. Now how many employees in your company have to handle this common-stock investment?

Mr. CLARKE. That is something that varies considerably from time to time. I would say it has run in different periods from a mere handful up to a dozen, to a score. I really never have looked at it quite that way so I am making an approximation. Final decision, of course, is in many less hands than that, but a lot of the essential analysis and sifting, and so on, involves these other people.

The CHAIRMAN. It is the responsibility of a certain number of individuals to devote their whole time to this common-stock operation, or does it reside in the finance committee which handles other investments, too?

Mr. CLARKE. The finance committee handles all the investments and the processing of that is done by selected people who may be also working on bonds.

The CHAIRMAN. In other words, you do not have to have a special common-stock set-up?

Mr. CLARKE. Not entirely separate, no.

The CHAIRMAN. The reason I asked that question is because you told us in your statement that there is really quite a substantial turnover in stocks. You purchase and sell. You have made substantial profits on some sales, and losses upon others. I will not use the word "substantial." But, as I recall the figures, amounts actually received for the stocks having a book value of $18,108,140.04 totaled $20,091,652.38; profits realized being $3,284,736.63, and losses $1,301,224.29, leaving the company a net profit on the $18,108,140.04 of $1,983,512.34, or 10.95 percent thereon in addition to dividends.

During what period would you say these losses amounting to $1,301,224.29 were suffered?

Mr. CLARKE. Well, all those figures embrace the period from the date of the first purchase in 1929 down to October 31. They were not concentrated at any particular time. There were profits and losses throughout those years. I could give them to you by years. I have them in my work sheets here, but they are very voluminous.

The CHAIRMAN. That is not necessary.

Mr. CLARKE. They are not concentrated in any short period; I can say that.

The CHAIRMAN. Well, the total loss as given by your statement here is equal to more than a third of the total profit on the sales.

Mr. CLARKE. That is right.

The CHAIRMAN. So that quite obviously a very substantial amount of sound judgment must be required to manage such a common-stock investment policy.

Mr. CLARKE. That is right. And may I put it this way: I think it is true that the selection and purchase of any given common stock, those two things are the lesser part of the duty of the portfolio manager. The watching it after and the decision as to when to part with it, or when to retain it, is really more important than making the original decision.

The CHAIRMAN. Would you say in the light of your experience you would recommend the abandonment or any modification of the operations of the SEC?

Mr. CLARKE. I would not recommend abandonment, no. Now I have not given careful thought in connection with this hearing to the present Securities Exchange Act. And yet I think it probably could be modified in the direction of simplification and practical operation. I cannot tell you in detail what the modifications ought to be, because I have not studied it.

The CHAIRMAN. I did not want any detailed answer to that. It was just the over-all question. Because in connection with investment studies one always hears the charge that SEC is too strict, that SEC is an obstacle to venture capital and that caused me to wonder.

Mr. CLARKE. That idea is very prevalent, I know.

The CHAIRMAN. Yes. But it raises the question in my mind whether an insurance person who has had active experience in investing trust funds in common stocks would feel that the SEC should be weakened. I take it your feeling is that it should not be weakened, but there might be some modification.

Mr. CLARKE. It might be simplified, yes.

The CHAIRMAN. Now, then, with respect to the watching of the stocks, you have just told us it becomes necessary for you to carefully observe the operations of the companies in which you have invested funds in common stocks. Do you try to exercise any influence of any kind upon the management of the companies?

Mr. CLARKE. In no instance that I can think of has that been done.

The CHAIRMAN. So that here we have an insurance company with more than $18,000,000 invested in common stocks, ranging from 139 industrials on the top to 12 railroads at the bottom.

Mr. CLARKE. That is the over-all figure for all the period, Senator.

The CHAIRMAN. Yes.

Mr. CLARKE. The present figures are on the preceding page, the next to the last paragraph. There are 96 now held at the time of September 30.

The CHAIRMAN. What is the total invested now in the 96 companies?

Mr. CLARKE. Eighteen and one-half million on September 30, in round figures.

The CHAIRMAN. So here we have a case of a company owning 18½ million dollars in common stocks of various industrial companies and exercising none of the managerial functions which, of course, reside in the holders of the common stock. That is the picture, is it not?

Mr. CLARKE. That is right.

The CHAIRMAN. So that there is a complete surrender to the management of these companies of all of the functions of management and no supervision by the corporate stockholders so far as you are concerned?

Mr. CLARKE. That is right.

Mr. SCOLL. Do you not ever have occasion to question the management in some of these situations where you are in common stocks?

Mr. CLARKE. Yes, Mr. Scoll; there have been times when we have refused to give proxies we have been requested to because we did not like something in a statement, or we did not approve of the purposes for which the proxies were apparently required. So we refrained. And we have sometimes requested additional information. So to that degree we have—I will not say interfered, although perhaps it is looked on as interference, but we have made particular inquiry and critical inquiry at times. Those have been in a relatively small number of cases.

The CHAIRMAN. Well, do you think that as a matter of policy the insurance company investor in common stocks should or should not take any part in actual corporate policy of the companies in which that common stock is held?

Mr. CLARKE. I think the life-insurance company should be very careful to maintain its role as that of the investor and not attempt to get into management of industrial enterprises, public utilities, railroads, or whatever it might be, because the managing of a life-insurance company is enough of a job for any management that I am familiar with. And I think it would be a great mistake to go over the lines of the investor, such as the role pursued by, maybe, the endowment funds of a university or of an investment trust of the highest class—to go over the lines from that role into the role of active management of all these other enterprises.

The CHAIRMAN. Must one assume from your statement that an investor is one who gives his money over to management and then lets management do what it pleases with it?

Mr. CLARKE. No; I would say he is one who watches closely and analyzes critically and acts objectively on the judgment he has acquired as a result of those processes. But he is detached from the management proper.

The CHAIRMAN. As I get the picture that you describe to us, it is that the investor should keep his hands off management; he should put his money in, and if he is not satisfied with the way management is going, then he ought to get out and let management tend to its own knitting, so to speak.

Mr. CLARKE. So far as we are talking of life-insurance companies as investors, yes, I would agree. If an individual in a small company, that is a different role.

The CHAIRMAN. The reason I asked the question that way, Mr. Clarke, was because you said you thought the life-insurance company ought to act as an investor would act.

Mr. CLARKE. I mean a professional investor like an investment trust or endowment fund of a university, or anything of that sort.

The CHAIRMAN. I see.

Mr. CLARKE. Someone managing a large block of investment funds, what you might call a professional investor as opposed to an individual investing his own money purely for his own income and speculation.

The CHAIRMAN. Then should it be provided, if any modification of law were suggested to permit investment by insurance companies in common stocks, that the insurance company should not take part in the management of those companies?

Mr. CLARKE. You ask if it should be?

The CHAIRMAN. Yes.

Mr. CLARKE. I think provisos tending that way would be advisable. They should be carefully drawn so that it would not restrict the right of the owner to inquire and to analyze and inspect, and all that sort of thing.

The CHAIRMAN. What is the provision of the California law?

Mr. CLARKE. You mean on the matter of——

The CHAIRMAN. Investment in common stocks.

Mr. CLARKE. I have the code here.

The CHAIRMAN. Mr. Scoll tells me it is in your answers.

Mr. CLARKE. It appears in the answers; that is right.

The CHAIRMAN. I think it might well be inserted here.

Mr. CLARKE. Yes; it is at the bottom of page 4 of the answers to the questions in the monograph. Do you want me to read it?

The CHAIRMAN. Let's read it into the record at this point.

Mr. CLARKE. It is in answer to question B IVa. [Reading:]

The California Insurance Code does not place a direct limit on the maximum amount of common stock permitted. The following limitations apply to all investments of so-called excess funds. These are all of an insurer's assets after it confines an amount equal to its required minimum paid in capital to certain restricted securities such as Government, State, and municipal bonds, mortgage loans meeting certain requirements and some other types of securities. The remaining assets are referred to in the California Code as excess funds and the following apply to them (sec. 1190, California Insurance Code)—

Such investments may be made in—

(1) Stock of any corporation organized and doing business under the laws of the United States or any State thereof or the District of Columbia (sec. 1191, California Insurance Code).

(2) Such stock must be dividend paying and any obligation purchased interest bearing (sec. 1195, California Insurance Code).

(3) It qualifies as a sound investment and is purchased at not over its current market value (sec. 1196, California Insurance Code).

(4) Stock purchased in any corporation must not exceed 25 percent of capital and surplus of the life-insurance company so purchasing (sec. 1198, California Insurance Code).

(5) Stock purchased may not exceed 30 percent of total outstanding stock of any one company. (There is an exception to this that applies only to purchase by one California insurance company of stock of another California insurance company) (sec. 1199, California Insurance Code).

The CHAIRMAN. Thank you very much.

Mr. Scoll, do you have any questions at that point?

Mr. SCOLL. No.

The CHAIRMAN. Have you any questions on this point, Congressman Herter?

Mr. HERTER. Not on this point; no.

The CHAIRMAN. On the general question of common stock investment?

Mr. HERTER. Yes; just one question I would like to ask.

I believe we are going to have testimony next week in regard to institutional purchases of shares in what you might call purely venture capital organizations.

In my home city of Boston there is a company called the American Research & Development Corp., which, as far as I know, is the first purely venture-capital organization that has institutional financing. John Hancock Life Insurance, I know, put money into it. One of our largest investment trusts has put some money into it. I was wondering whether in the insurance field there is anything other than the example I happen to know about of that type of thing. Obviously, it is a very, very small percentage of the assets of the insurance company or the investment-trust company that have gone into it, but it is at least interesting as a fairly new development. I think it has only been organized 2 years.

Mr. CLARKE. I believe, Mr. Herter, it is a very new development and that the one company you speak of is, I think, the only one I know of that is making that exact approach to the problem. And you might almost think of it as a laboratory experiment yet. I would say it is a pilot case. Maybe if we knew more about it through trial and error methods we could be much more learned in passing on it. I think it is a very interesting plan. It is one that should be watched and followed very closely by all of us who are interested in investments. Now, in saying that, I realize that participation in that would go outside the boundaries that I have sort of drawn here.

Mr. HERTER. Entirely.

Mr. CLARKE. But it is because that is a new idea—and I am not one to say that a new idea ought to just be excluded. I do not want to seem inconsistent in saying that, although I did not envisage anything like that when I prepared this statement. It might be that some loophole should be left—I will not call it a loophole, but some exception there that the company should be allowed to some very limited percentage to explore ideas like that. But I think it is too new for us to be very dogmatic about it.

Mr. HERTER. The reason I was asking that, I noted that in your answer to the questionnaire you spoke of the privately placed bond issue or notes that you buy from private corporations, and that the really economic limits which you feel you can handle is $250,000; if it gets below that, the cost of making your investigation and study of the project, and so on, hardly makes it worth while. It is very occasionally you get down to $50,000 or $75,000.

Mr. CLARKE. Yes.

Mr. HERTER. Which means a pretty large single investment, comparatively large at least, from the point of view of what one might consider new and fairly untried businesses.

Mr. CLARKE. Yes.

Mr. HERTER. I fully understand the reason for that. But I was wondering if you could tell us a little about a question that I tried to develop yesterday. That relates to the growing practice of investment bankers making offerings to the insurance companies and splitting up the amount that may be required in a number of different companies. Does that in any way change the amount that you are likely to take? Do you prefer to go into the whole thing and make your own investigation rather than have investment bankers offer you a participation in, say, a $10,000,000 loan?

Mr. CLARKE. Well, I would not say we would prefer. I would say that there are times when we are very glad in a larger issue to take a small part of it, because so much of the work has been done, and we can, with comparatively little research and little investigation, act even though much smaller amounts are involved.

That has been particularly true in the case of some small telephone and water companies. They are in, I think, my answers to the supplemental questions. They will appear there. Through the years we have financed some down as low as 50 or 60 thousand, one even at 35,000, a small water company, where credit was unquestioned. Those have been exceptions.

There is another exception that occurs to me. We have frequently found small applicants coming to us occasionally through a broker or investment banker, sometimes indirectly, more often maybe directly, asking for a bond issue or debenture money, or something like that. But when we looked into it, we did not feel there was a proper basis, and yet in looking at the statement, we would see that there was a possibiilty of a real-estate loan there.

The man had come in, he was not familiar with finance at all, and needed money and did not care what form he borrowed it, and we loaned his 25 or 30 thousand dollars on a real estate loan at much less expense and much less red tape, and so on, when what he started out to do was to do some financing and did not know how to go about it.

There have been many cases like that where we found a real-estate mortgage solved the problem. The borrower was satisfied because what he wanted was the money and had very little interest in the channel through which he got it. That is, the paper method.

Mr. HERTER. In the case of real-estate mortgages you do have to take a much more active interest in management than in these other investments, do you not?

Mr. CLARKE. I would say in our company maybe because two of the most active members of the finance committee—one other man as well as myself, and we are former bankers—we approach the making of a real-estate loan on business property probably much more like the commercial banker. We are not primarily interested in the real estate per se. We want to see the statement of that concern, its earnings over a period, the know-how of management, its character, and that sort of thing. If those are good then, of course, the property must qualify under our code. It must qualify for a real-estate loan.

But if those other factors are not good, then we will not make the loan even though the real estate itself will qualify.

Mr. HERTER. Have you yourself gone into housing developments or anything of that kind wholly owned by you?

Mr. CLARKE. Not housing development.

Mr. HERTER. I notice in your statement in regard to your common stock return that over the period of 20 years, with unrealized capital gains, it same to around 7 percent.

Mr. CLARKE. That is right.

Mr. HERTER. What percentage are they of your total portfolio? Perhaps your figure is in there.

Mr. CLARKE. At the present time it is about 7½ or 8 percent.

Mr. HERTER. Of the total portfolio?

Mr. CLARKE. Total admitted assets of the company.

Mr. HERTER. What percentage have you in Government bonds, just roughly?

Mr. CLARKE. It will take me a moment to give you the answer, but I think I have it.

Mr. HERTER. I was not interested in the exact figure, but in the trend. Has your investment policy been following the general trend of the 17 largest insurance companies of reducing the percentage of holdings in bonds and increasing your percentage in public utilities, industrials?

Mr. CLARKE. I am afraid we have been rather unorthodox in that respect. As I mentioned before, we have gone stronger for mortgages than we have for bonds; and, yet, this past year, for example, our holdings of Government bonds have increased while they have been going down generally. We have just seemed to follow an opposite course.

In fact, just in the last few weeks we have made several purchases. So that I think we will end the year 1949 with more Government bonds than we had at the end of 1948. I can answer you now.

I have the figure only for December 31, 1948, here on the Government's. The United States Government's were 16,194,000. The Canadian Government's—we do business up there in six provinces—3,631,000. That was just under 20,000,000 for the two. They are larger now.

Mr. HERTER. What percentage is that roughly of your total?

Mr. CLARKE. Just under 10.

Mr. HERTER. Just under 10 percent?

Mr. CLARKE. Just under 10. Percentage-wise I do not think it is any more now, but the amount has gone up this year.

Mr. HERTER. That is considerably less than the average shown for the companies.

Mr. CLARKE. Our mortgages are much more.

Mr. HERTER. One other figure. What do your general earnings run to? The average for the 17 companies was given, I think, as 2.90. Yours must run considerably higher than that.

Mr. CLARKE. Yes. Our earnings for this year 1949 up to the end of the third quarter were 3.67.

Mr. HERTER. That compares quite favorably with investment trusts generally, does it not?

Mr. CLARKE. I think so.

Mr. HERTER. Thank you.

The CHAIRMAN. There was another question that I would like to develop with you, Mr. Clarke. On page 3 of your statement you made reference to the obligations which a life insurance company must meet: Payments to its beneficiaries, and so forth. Then, the other disbursements, such as salaries, rents, and many other expense items.

Then you say the demand upon its gross income may, therefore, vary greatly from year to year, quite apart from fluctuations and mortality, policy loans, and surrender values. One of the surest ways to mitigate the violence of such fluctuations is through a portfolio of common stocks where investment is permitted.

Now, is there a violent fluctuation in those other disbursements?

Mr. CLARKE. Well, it is a relative term, I would say. Thinking of it as a curve, the process I am speaking of will make the peaks and dips of that curve more gradual than otherwise. Maybe the word "violent" is a little too extreme a term.

The CHAIRMAN. Your operating costs do not vary at any great rate, do they, from year to year?

Mr. CLARKE. They have been steadily mounting with the declining purchasing power of the dollar. Salaries is the largest item, and rents of our various offices—we have had a great many step-up changes in our leases.

The CHAIRMAN. That is a steady rise rather than a violent fluctuation.

Mr. CLARKE. Thinking over the long period—and that is what life insurance is, a business of long cycles—you get the other end in a period like the thirties.

The CHAIRMAN. How about the trend of payments to policyholders or beneficiaries? Does that follow a general curve, or does that fluctuate?

Mr. CLARKE. That will not fluctuate like these other items, because it is geared to mortality and maturities of endowments and things of that sort.

The CHAIRMAN. You told us that you made a profit of 10.95 percent on the handling of common stocks in addition to any dividends received. What is the rate of profit on your real estate mortgages, which according to your statement are very much larger in amount?

Mr. CLARKE. I can give you that in just a moment. The net interest received on mortgage loans starting in this same year 1929, down to October 31, 1949, was 4.686 percent.

The CHAIRMAN. How about real estate held for investment? That is a small amount, but you hold it for investment, 4½ million. Does that show appreciation?

Mr. CLARKE. It is all so very recent that there has been no real appreciation.

The CHAIRMAN. Now, Mr. Clarke, as a Californian and assuming you have invested a lot in California real estate, are you going to miss this opportunity?

Mr. CLARKE. Do you want another chamber of commerce speech? Of course, I hate to disappoint you, Senator.

I have some figures here somewhere on those 13 parcels. I can say this: Their rate is over the average rate for the company. We have not figured appreciation of the properties for the reason that all those properties are subject to long leases where the rent is stipulated in the leases. In some cases there are percentage clauses, percentages of sales.

The CHAIRMAN. Suppose you boil that down after the session and have it inserted in the record.

Mr. CLARKE. Yes; I can get that for you fairly soon.

(The material referred to above is as follows:)

Average yield to date on the 13 properties in question has been 5.13326 percent.

The CHAIRMAN. How about the rate of return on policy loans? You have got 8½ million in policy loans.

Mr. CLARKE. Well, I have not figured that one either.

The CHAIRMAN. Do you give the policyholder a break and give him a low rate of interest?

Mr. CLARKE. All those made of late years on policies written in the last—I have not looked, but I would say last 5 or 6 years, without checking—maybe it is longer than that—have carried, I think it is, 4.8. They used to have way back, many years ago, some of them were 6 percent and 5 percent. We have always charged whatever the rate stated in the policy provided. What the average is on all that, on that 8½ million, I do not have the figure with me as to the return, but I could get it.

(The material referred to above is as follows:)

The net rate of return on policy loans for the year 1948 was 4.59 percent after making due allowance for cost of handling. These loans consist of a great many items with a quite nominal amount as their average.

The CHAIRMAN. When you were presenting your figures on the sale of stocks and bonds, I called attention to the fact that while you gave us the percentage of profit on your dealings in stocks, we did not have the percentage on the bonds.

Mr. CLARKE. You would like that?

The CHAIRMAN. I have had that computation made here. The book value you set down on page 4 as $43,310,467.48, profits totaled $3,127,666.80, losses amounted to $1,125,608.91, or a net profit of $2,002,057.89. That roughly amounts to a profit of 4.7.

Mr. CLARKE. It looks like that.

The CHAIRMAN. On $43,310,000, as compared with 10.95 on the common stocks. Would you say that is probably correct?

Mr. CLARKE. Would you not have to compute that profit on the bonds that were sold? You see, that sale on the book value of $133,000,000——

The CHAIRMAN. If you computed on that value, then the rate of profit is only 1.5.

Mr. CLARKE. It would be much lower; yes, that is right. I have not figured it out, but that would be the correct basis to take, the ones sold.

The CHAIRMAN. That is really a very substantial variance in the rate of profit.

Mr. CLARKE. Very. I myself was surprised when I saw the figures.

The CHAIRMAN. It points to the great necessity of the most careful handling of common stocks, even though your law does permit it; does it not?

Mr. CLARKE. Yes.

The CHAIRMAN. Now, with respect to the discussion which you had at the end of the paper, beginning on page 9, about the flow of funds into equity financing, I am not altogether certain that there has been any definite charge that life insurance has prevented this flow. At least, so far as we are concerned, we are merely trying to find out what the facts are.

My personal judgment is that we are facing facts which have come about not as the result of any deliberate policy upon the part of anybody in or out of life insurance, but due to the growth of the economy. So our purpose is to find out what, if anything, Congress should do to stimulate the flow of equity capital, because, as you say in your conclusion, the present trend could in time bring about an unstable equilibrium if debt is to increase indefinitely while the equity base remains fairly stationary.

So that this discussion about what is happening to insurance funds is based not upon any hostitility to insurance investment in these things. It is merely an inquiry to determine precisely what the facts are.

It seems to be pretty well developed from the evidence that has been laid before us to date that the small business people who came to us on Tuesday afternoon and said that they cannot get the money that small business needs is pretty well borne out by what has been testified to date, that the structure of our economy is such the the large borrower gets the bulk of the funds and the little fellow gets just what is left.

The statistics, particularly the statistics submitted by Mr. Woodward yesterday afternoon, as well as those submitted by Mr. Lincoln in the morning, showed, just as the RFC statistics showed to another subcommittee here, that the little fellow gets the smallest aggregate total of the investment bonds.

And yet, on the side of the consumer it is the aggregation of the purchasing power of the little people which creates the biggest market for all business and industry. In insurance, since the average insurance policy, if I remember Mr. Woodward's figures yesterday correctly, is now $4,800, it is clear that there must be hundreds of thousands, if not millions, of very small policies to bring the average down that low.

So our problem here is to find sound ways and means of encouraging the flow of capital, whether by way of debt or by way of equity, to small business. Have you any suggestion to us about that?

Mr. CLARKE. Well, of course, maybe not a suggetion but a comment. The little fellow has difficulty getting those funds because on too many occasions—and I am speaking now as a former banker, and I have been a banker both in a fairly small community and in a large city—the small man too often has very little credit, he has very little basis for credit, either in assets or performance. He has not demonstrated ability to pay that warrants a lender advancing him credit.

I have many, many times taken a great deal more pains and spent much more time in analyzing a small borrower or small applicant's situation, and after I got through and made him a loan, had a lot more doubt as to whether I had been right or not than I have on a large one, because the means of ascertaining his situation are scantier, and there is much more work to do to find out whether he can qualify. Many are called and few are chosen.

The CHAIRMAN. That leads us, then, directly to two questions: whether the mature company is the one that is being favored by present investment policies and whether, therefore, the course of investment tends to strengthen the big unit at the expense of the little unit and then, secondly, to what extent the State insurance company like the Occidental provides a better vehicle for little and local business than does the great national organizations.

Mr. Scoll, I would like to have you pursue that. I think you have been over that subject.

Mr. SCOLL. Well, can you give us, Mr. Clarke, some idea of the minimum and maximum size of the investments which you make?

Mr. CLARKE. You are getting now over into the answers to monograph questions?

Mr. SCOLL. That is right.

Mr. CLARKE. In the case of real-estate loans, we have no formal minimum. We do in practice avoid whenever possible the making of a loan under 1,500 or certainly a thousand dollars. We do this as much in the interest of the borrower as our own, for the reason that appraisal and title fees, et cetera, even at their lowest possible minimum, total too much in proportion to the amount involved.

On the other hand, in the purchase of special district bonds based on specific assessments against separate pieces of property like sewer districts, we have taken on individual items of quite nominal amounts, where they were part of an over-all investment in the particular area, even though on any one given item the yield would be too small to cover the cost of handling.

Generally speaking, where a corporate bond issue is involved, we try to invest in units of not less than, say, 250,000. In that I know

Mr. Herter raised the question there, I mean there where we are buying issues from underwriters or listed issues. I did not mean so much direct financing where we were receiving an application from a borrower for a direct loan. I was referring there to bonds that are commonly dealt in—on the theory that relatively too much time and attention is spent in following small blocks of separate issues. Again we make exceptions to this practice in the case of some directly financed private deals with small public utilities where on occasion the total amount of the original investment has gone as low as fifty to seventy-five thousand dollars. In practice, however, the applicants have usually not presented such deals because of the ratio of expense to the amount involved and have only brought them in if they amounted to $200,000 or more.

While our California code establishes higher limits, we have usually held total investment in any single bond issue to $1,000,000 or under and in any one real estate loan I can only recall one instance where the initial amount loaned was as much as $1,000,000. We have a commitment pending right now, disbursement of which should occur within the coming year, of $1,100,000. This involves the purchase of an improved parcel of business property to be leased for a long period of years to a mercantile concern as provided in section 1194.8 of the California Insurance Code. Outside of holdings of Government bonds, I believe it will be the largest single investment our company has yet made.

Mr. Scoll. Now, you indicated in an answer to a question from the Senator that your investments are pretty widespread. Most of them are concentrated in the West?

Mr. Clarke. No; I have a break-down of that.

Mr. Scoll. We can probably get the answer by reference to the tables.

Mr. Clarke. I can give it to you by States. We have very heavy real-estate loans in the States outside the West—Illinois, for example, Michigan——

Mr. Herter. Texas?

Mr. Clarke. Texas is very heavy; yes.

Mr. Scoll. I have no further questions.

Mr. Clarke. I have my geographical distribution here now of the mortgage loans, if you are interested.

Mr. Scoll. Isn't that also contained in the tables you submitted to us?

Mr. Clarke. Yes; I guess it is in the supplemental part.

The Chairman. It will be satisfactory to you, I take it, Mr. Clarke, to have these written answers to the written questions inserted in the record at this point?

Mr. Clarke. Yes, Senator.

The Chairman. That will be done.

(The material referred to above is as follows:)

Home Office,
Occidental Life Insurance Co. of California,
Los Angeles, Calif., December 5, 1949.

Mr. John W. Lehman,
Clerk, Joint Committee on the Economic Report, Subcommittee on Investment, Senate Office Building, Washington, D. C.

Dear Sir: Pursuant to a request from Dr. James J. O'Leary, I hand you herewith answers that I have prepared or had prepared to questions propounded on memorandum headed "Supplemental life insurance data" dated November 14, 1949.

Accompanying these answers are a number of exhibits of statistical material for the use of the committee, its staff, and its counsel.

I have one comment in connection with the same. Referring to the answer shown on the exhibit headed "Question D1," I feel I should point out that while the same is absolutely accurate as to the mortgage loans and real estate listed, I feel that the classification of bonds and common and preferred stocks according to the State of incorporation is inadequate. I know that this portion of the answer would be greatly altered if we had sufficient time to make a proper survey of this feature of the question. Obviously Delaware would not show up with anything like these figures as to bonds and probably not as to preferred and common stocks. In many instances the subject concerns are national in prominence and distribution of facilities and therefore an accurate geographical classification of our investment in them would require a very extended survey.

Yours very truly,

DWIGHT L. CLARKE, *President.*

ANSWERS BY DWIGHT L. CLARKE, PRESIDENT OF OCCIDENTAL LIFE INSURANCE CO. OF CALIFORNIA, TO QUESTIONS PROPOUNDED ON MEMORANDUM HEADED "SUPPLEMENTAL LIFE INSURANCE DATA" OF NOVEMBER 14, 1949

To the Subcommittee on Investment of the Joint Committee on the Economic Report.

MR. CHAIRMAN AND GENTLEMEN: A. The persons charged with the management of our portfolio have constantly before them the problem of relating over-all economic trends to both our company's investment requirements and the action taken on each individual issue whether the purchase or the sale of the same is involved. One can hardly exaggerate the degree to which this enters into our daily thinking.

A-1. We know of none; while informal discussions with officials of other companies take place from time to time, there is actually a great deal more competition and pursuit of independent policies than there is anything like coordination.

A-2. We try to ascertain both whether the company under consideration is making a profit and as to how soundly based and permanent the same is in relation to the general economy and to the industry as a whole. Beyond this we would say that there is very slight evaluation and nothing like an attempt to dictate pricing policy.

B. Generally speaking we believe it is fundamentally untrue that life insurance companies are increasingly drawing funds from localities where they are needed and investing them in localities where they are not needed. Does not the question almost destroy itself? How could we invest funds in localities where the same are not needed? Who would pay interest or other yield for such investment if it were not economically feasible?

I hesitate to burden this answer with too voluminous data but it so happens that about 10 years ago I was chairman of a committee that conducted a survey of many months' duration regarding the withdrawal and reinvestment in every form of life insurance funds in the County of Los Angeles, Calif. I might say that one of the purposes of this survey was to provide as accurately as possible an answer to the general charge that lies behind the present question. I still have a copy of that survey which I will be glad to furnish if desired but at this point will merely say that at the time in question life insurance was collecting about $75,000,000 annually in premiums from Los Angeles County, that at that time there was in excess of $2,400,000,000 of life insurance in force on residents of Los Angeles County, that new insurance purchased by them in 1939 totaled $286,000,000. Against the $75,000,000 in premiums paid by residents, the companies disbursed in commissions, salaries, rents, real estate taxes, general overhead and payments to policyholders, $66,670,000, plus premium taxes allocable to the Los Angeles business of $1,181,000. These two figures totaled nearly $68,000,000 or about $7,000,000 less than the premiums. As of the same time the life insurance companies had invested in Los Angeles real estate over $29,000,000, had mortgage loans on Los Angeles property of $158,404,000, and bonds of the county, the municipalities, and districts within it of $61,000,000, and bonds of various public utilities, railroads, et cetera, allotable on a fairly precise basis to Los Angeles of another $89,595,000, preferred and common stocks of such utilities for $3,509,000, and bonds and stocks of other purely local enterprises in excess of $24,000,000. The total of all these investments at that time was about $366,000,000 as against the excess of premiums over other disbursements of about $7,000,000. That seems to dispose of this question so far as Los Angeles in 1939 might be considered a fair example.

C. Answers to the 12 subdivisions of question C will be found on the attached exhibit headed "Supplemental life insurance data—question C."

D. In answer to the various subdivisions of question D, there are attached hereto three exhibits marked "Supplemental Life Insurance Data—D-1, D-2, and D-7."

D-3. The answer to suggestion 3 under said D will be found in exhibit C hereinabove mentioned (first column thereof headed "Classification").

D-4. In the limited time available we have found it impractical to provide adequate answers to subquestion 4 under D setting forth purpose of loans. Generally it may be said, as to our real-estate loans, that the vast majority of same, especially our residential loans, were made to assist in the purchase of the subject property by the borrower.

D-5. There is attached hereto an exhibit marked "Supplemental Life Insurance Data—Question D-5a" which gives the range of interest rates on all bonds acquired during 1948, the range of interest on bonds owned as of December 31, 1948, the yield to maturity on bonds acquired during 1948 and for the first 10 months of this year.

As to the mortgage loans made during 1948, there is attached hereto an exhibit marked "Supplemental Life Insurance Data—Question D-5b."

For its further bearing on this subject of interest rates, the following schedule shows the net interest earned by Occidental Life Insurance Co. of California on all its invested assets for each of the years from 1930 through 1948:

	Percent
1930	5.02
1931	4.54
1932	4.18
1933	4.66
1934	4.13
1935	4.28
1936	4.08
1937	4.19
1938	4.07
1939	3.93
1940	3.86
1941	3.87
1942	3.92
1943	3.40
1944	3.60
1945	3.33
1946	3.29
1947	3.52
1948	3.58

E-2. The answers to question E-2 will be found on the exhibit marked "Supplemental Life Insurance Data—Question E-2."

F. The pressure on life-insurance companies mentioned in the question is undoubtedly contributing to an increasing degree to the present low level of interest rates although not to the degree that is true of the pressure exercised by the Government and governmental agencies to keep interest rates at an artificially low level. We do not know of any way to measure the quantitative extent of the pressure on life insurance companies above mentioned.

G. The effect that possible price declines would have on the worth and paying ability of any applicant corporation is one of the caluculations that enters into the loan officer's thinking every time he considers an application. The practical solution he finds in many instances is to assume a lower rate of return or a lower commodity price level than that presently in force when he appraises the worth and analyzes the financial statement of the applicant company.

(The tables submitted by Mr. Clarke are as follows:)

Supplemental life insurance data—Question C

Classification	Acquired during 1948					Owned Dec. 31, 1948				
	Total	Bonds	Stocks	Mortgage loans	Real estate	Total	Bonds	Stocks	Mortgage loans	Real estate
1. Manufacturing	$5, 222, 398. 84	$3, 004, 263. 75	$184, 300. 00	$2, 033, 835. 09	0	$22, 177, 354. 66	$4, 247, 267. 00	$11, 587, 737. 00	$5, 415, 071. 00	$927, 279. 66
2. Trade	4, 102, 490. 71	250, 000. 00	67, 698. 31	1, 696, 800. 00	$2, 087, 992. 40	14, 326, 838. 39	250, 000. 00	2, 122, 018. 00	8, 769, 650. 00	3, 185, 170. 39
3. Electricity, gas, water, and telephone	3, 468, 848. 70	2, 653, 398. 70	815, 450. 00	0	0	11, 741, 953. 00	8, 305, 752. 00	3, 436, 201. 00	0	0
4. Railroads	6, 818, 949. 36	6, 818, 949. 36		0	0	8, 256, 814. 00	6, 858, 292. 00	1, 398, 522. 00	0	0
5. Other transportation	307, 444. 16	0	0	0	307, 444. 16	1, 112, 226. 76	804, 782. 60	0	0	307, 444. 16
6. Single-family residential real-estate mortgages	24, 742, 682. 75	0	0	24, 742, 682. 75	0	77, 693, 209. 13	0	0	77, 693, 209. 13	0
7. Multifamily residential real-estate mortgages	340, 000. 00	0	0	340, 000. 00	0	4, 053, 391. 00	0	0	4, 053, 391. 00	0
8. Multifamily real-estate direct investments	0	0	0	0	0	0	0	0	0	0
9. Mortgages on commercial real estate held for rental purposes, such as office buildings, garages, loft buildings, hotels, etc	0	0	0	0	0	0	0	0	0	30
10. Mining, including oil and gas	0	0	0	0	0	184, 571. 00	0	184, 571. 00	0	0
11. U. S. Government securities	8, 570, 168. 06	8, 570, 168. 06	0	0	0	16, 084, 093. 00	16, 084, 093. 00	0	0	0
11-A. Canadian Government securities	914, 400. 00	914, 400. 00	0	0	0	3, 631, 005. 00	3, 631, 005. 00	0	0	0
12. Securities issued by public authorities other than the U. S. Government, including State, county, and municipal governments	[1] 2, 522, 968. 89	[1] 2, 522, 968. 89	0	0	0	402, 730. 00	402, 730. 00	0	0	0
12-A. Finance and other	1, 400, 822. 33	0	0	1, 400, 822. 33	0	[2] 20, 392, 978. 89	0	10, 335, 734. 00	[2] 10, 057, 244. 89	0
Total	58, 411, 173. 80	24, 734, 148. 76	1, 067, 448. 31	30, 214, 140. 17	2, 395, 436. 56	180, 057, 164. 83	40, 583, 921. 60	29, 064, 783. 00	105, 988, 566. 02	4, 419, 894. 21
Bonds	24, 734, 148. 76						40, 583, 921. 60			
Stocks	1, 067, 448. 31						29, 064, 783. 00			
Mortgage loans	30, 214, 140. 17						105, 988, 566. 02			
Real estate	2, 395, 436. 56						4, 419, 894. 21			
Total	58, 411, 173. 80						180, 057, 164. 83			

[1] Includes $2,405,545.84 Federal home-loan banks and Federal intermediate-credit banks.

[2] Includes $7,458,527.89 farm-mortgage loans.

[3] Included in class 2.

Question D-1—Geographical locations, Dec. 31, 1948

United States	Mortgage loans	Bonds [1]	Stocks		Real estate	Total
			Common	Preferred		
Alabama	$11,588.35		$130,673			$142,261.35
Arizona	2,331,029.31	$400,000.00				2,731,029.31
Arkansas	1,220,336.59					1,220,336.59
California	25,749,318.51	5,321,279.00	3,862,827	$1,227,905	$4,112,450.05	40,273,779.56
Colorado	2,633,406.42			153,375		2,786,781.42
Connecticut			98,300	159,988		258,288.00
Delaware		2,391,464.00	3,560,171	936,000		6,887,635.00
Florida				56,379		56,379.00
Hawaii		128,414.00				128,414.00
Idaho	473,565.65					473,565.65
Illinois	12,335,972.02	446,403.00	1,057,859			13,840,234.02
Indiana	1,955,407.95	308,503.00	117,555	103,125		2,484,590.95
Iowa	163,909.30					163,909.30
Kansas	3,161,776.01					3,161,776.01
Kentucky		344,743.00	128,845			473,588.00
Louisiana	3,020,649.96					3,020,649.96
Maine		233,219.00	226,603	197,300		657,122.00
Maryland	20,869.74		340,177	442,091		803,137.74
Massachusetts		90,199.00	72,793			162,992.00
Michigan	5,270,135.76	301,187.00	210,812			5,782,134.76
Minnesota	171,647.65	605,100.00	116,572	84,322		977,641.65
Missouri	226,091.48	808,586.60				1,034,673.08
Montana	498,858.61		184,571			683,429.61
Nebraska	62,939.17					62,939.17
Nevada	1,530,199.91		50,000			1,580,199.91
New Hampshire		129,094.00				129,094.00
New Jersey		1,821,783.00	2,919,115	219,625		4,960,523.00
New Mexico	2,328,354.54					2,328,354.54
New York		998,676.00	4,651,424	324,071		5,974,171.00
North Dakota	2,225.24					2,225.24
Ohio	3,329,855.28		773,049	362,342		4,465,246.28
Oklahoma	9,269,891.21					9,269,891.21
Oregon	250,641.09		275,000		307,444.161	833,085.25
Pennsylvania	1,780,796.32	1,826,850.00	1,374,503			4,982,149.32
South Dakota	5,450.93					5,450.93
Texas	17,856,733.26					17,856,733.26
Utah	571,778.11	1,045,014.00				1,616,792.11
Virginia		2,025,307.00	768,784			2,794,091.00
Washington	2,252,076.57		539,489			2,791,565.57
Wisconsin		752,506.00				752,506.00
Wyoming	1,881,583.96					1,881,583.96
Total	100,367,088.90	19,978,327.60	21,459,122	4,266,523	4,419,894.21	150,490,955.71
Miscellaneous:						
International Bank	0	357,000.00	0	0	0	357,000.00
National Banking Act	0	0	3,339,138	0	0	3,339,138.00
U. S. Government and instrumentalities	0	16,194,652.00	0	0	0	16,194,652.00
Total miscellaneous	0	16,551,652.00	3,339,138	0	0	19,890,790.00
Canada	5,621,477.12	4,053,942.00	0	0	0	9,675,419.12
Grand total	105,988,566.02	40,583,921.60	24,798,260	4,266,523	4,419,894.21	180,057,164.83
Bonds						40,583,921.60
Common stocks						24,798,260.00
Preferred stocks						4,266,523.00
Mortgage loans						105,988,566.02
Real estate						4,419,894.21
Total						180,057,164.83

[1] Classified according to State of incorporation.

SUPPLEMENTAL LIFE INSURANCE DATA—QUESTION D-2—*Invested units, December 31, 1948*

	Total		Bonds		Common stocks		Preferred stocks		Mortgage loans		Real estate for investment	
	Number	*Amount*	*Number*	*Amount*	*Number*	*Amount*	*Number*	*Amount*	*Number*	*Amount*	*Number*	*Amount*
Under $25,000	19,047	$85,532,124.31	10	$124,731.00	4	$83,776	2	$24,130	19,031	$85,299,487.31	0	0
$25,000 to $50,000	114	4,158,337.20	16	634,205.00	9	352,312	7	264,717	82	2,907,103.20	0	0
$50,000 to $100,000	122	8,416,441.12	26	1,788,785.00	23	1,756,849	12	804,464	61	4,066,343.12	0	0
Over $100,000	286	81,950,262.20	88	38,036,200.60	94	22,605,323	20	3,173,212	71	13,715,632.39	13	$4,419,894.21
Total	19,569	180,057,164.83	140	40,583,921.60	130	24,798,260	41	4,266,523	19,245	105,988,566.02	13	4,419,894.21
Bonds	140	40,583,921.60										
Common stocks	130	24,798,260.00										
Preferred stocks	41	4,266,523.00										
Mortgage loans	19,245	105,988,566.02										
Real estate	13	4,419,894.21										
Total	19,569	180,057,164.83										

Supplemental life insurance data—Question—D-5a

BONDS ACQUIRED YEAR 1948 (BY CLASSIFICATION)

	Interest rates	Number of issues	Cost
Government:			
United States	1⅛–2½	9	$10, 975, 713. 90
Canada	3	6	914, 400. 00
Total		15	11, 890, 113. 90
Municipals	6	1	117, 423. 05
Railroads:			
Mortgage	2¼–4¼	6	3, 023, 106. 25
Debentures (convertible)	3¼	1	398, 000. 00
Equipment trust	2¼–2⅝	31	3. 397, 843. 11
Total		38	6, 818, 949. 36
Utilities:			
Mortgage	3–3¼	3	921, 848. 70
Debentures	2¾–3⅛	4	1, 229, 100. 00
Promissory notes	3½–4½	4	502, 450. 00
Total		11	2, 653, 398. 70
Industrial and miscellaneous:			
Debentures	2. 35–3	5	1, 846, 763. 75
Debentures (convertible)	2. 65	1	757, 500. 00
Promissory note	4¼	1	400, 000. 00
Secured note	4¾	1	250, 000. 00
Total		8	3, 254, 263. 75
Grand total		73	24, 734, 148. 76

BONDS OWNED DEC. 31, 1948 (BY CLASSIFICATION)

	Interest rates	Number of issues	Book value
Government:			
United States	1. 55–4½	25	$16, 194, 652. 00
Canada	3–4½	10	3, 631, 005. 00
Total		35	19, 825, 657. 00
States, Territories, and possessions	3–3½	4	99, 214. 00
Municipal:			
United States	6	1	117, 423. 00
Canada	3	1	75, 534. 00
Total		2	192, 957. 00
Railroads:			
Mortgage	2¼–5	8	2, 183, 455. 00
Debentures (convertible)	3¼	1	398, 292. 00
Equipment trust	2¼–2⅝	29	3, 276, 545. 00
Total		38	6, 858, 292. 00
Utilities:			
Mortgage	2¾–4½	29	7, 086, 412. 60
Debentures	2¼–3⅛	8	1, 234, 672. 00
Promissory notes	3½–4½	9	789, 450. 00
Total		46	9, 110, 534. 60
Industrial and miscellaneous:			
Debentures	2. 35–3½	10	2, 732, 868. 00
Debentures (convertible)	2. 65	1	757, 399. 00
Promissory note	4¼	1	400, 000. 00
Secured note	4¾	1	250, 000. 00
International Bank	2¼–3	2	357, 000. 00
Total		15	4, 497, 267. 00
Grand total		140	40, 583, 921. 60

Supplemental life-insurance data—Question D–5a

BONDS ACQUIRED DURING YEAR 1948

Yield to maturity:	*Cost*	Yield to maturity:	*Cost*
1.09	$1,000,324.29	2.86	$127,031.25
1.50	1,000,370.83	2.87	73,931.50
1.53	310,096.00	2.88	215,050.00
1.55	590,000.00	2.90	98,478.02
1.61	250,078.13	2.92	504,375.00
1.625	255,000.00	2.94	68,925.00
1.64	507,031.25	2.95	130,919.50
1.67	506,953.13	2.96	75,375.00
1.81	3,939,609.39	3.00	830,000.00
1.83	1,616,250.00	3.01	44,767.50
2.05	145,321.66	3.05	287,430.00
2.15	193,377.92	3.06	76,125.00
2.25	139,381.16	3.07	7,540.00
2.40	197,835.61	3.08	9,400.00
2.475	196,229.14	3.10	1,316,829.20
2.50	1,362,184.69	3.11	250,937.50
2.53	165,060.00	3.13	102,375.00
2.60	1,039,792.25	3.23	899,475.00
2.65	297,826.46	3.33	563,992.50
2.70	228,938.32	3.34	416,000.00
2.725	213,296.61	3.36	169,462.50
2.75	613,568.49	3.37	108,000.00
2.77	138,337.00	3.39	398,000.00
2.78	189,060.00	3.50	233,000.00
2.79	127,968.75	3.61	15,800.00
2.80	399,841.88	4.00	69,450.00
2.81	197,925.00	4.25	400,000.00
2.82	94,000.00	4.50	200,000.00
2.825	48,990.70	4.75	250,000.88
2.83	505,829.63	5.61	117,423.05
2.84	23,500.00		
2.85	180,077.07	Total	24,734,148.76

BONDS ACQUIRED, JAN. 1 TO OCT. 31, 1949

Yield to maturity:	*Cost*		*Cost*
1.01	$750,652.50	2.82	570,375.00
1.04	250,197.69	2.825	86,604.11
1.08	2,001,695.93	2.83	153,375.00
1.26	500,665.15	2.84	102,125.00
1.45	900,667.74	2.85	97,573.07
1.55	1,030,600.00	2.86	23,500.00
1.80	593,250.00	2.87	76,406.25
2.05	25,562.50	2.90	19,531.73
2.35	76,992.19	2.91	202,250.00
2.36	510,390.63	2.97	704,473.00
2.39	228,761.72	2.98	858,270.00
2.40	2,443,642.19	3.02	32,387.50
2.50	100,000.00	3.03	27,750.00
2.52	205,000.00	3.05	542,008.50
2.55	98,363.61	3.125	160,370.00
2.60	340,928.47	3.17	9,150.00
2.625	288,126.32	3.20	45,500.00
2.65	140,628.59	3.24	6,317.50
2.675	363,373.61	3.25	4,506.25
2.70	1,944,375.98	3.26	77,600.00
2.725	126,602.06	3.27	4,837.50
2.75	175,476.16	3.33	47,750.00
2.76	103,375.00	3.46	251,250.00
2.77	51,562.50	3.47	125,625.00
2.78	61,800.00	3.54	41,000.00
2.80	14,754.72	3.81	130,312.50
2.81	155,375.00	3.82	129,115.00

Supplemental life-insurance data—Question D-5a—Continued

BONDS ACQUIRED, JAN. 1 TO OCT. 31. 1949—continued

Yield to maturity:	*Cost*	Yield to maturity:	*Cost*
3.83	$130, 410. 00	4.80	$10, 230. 00
3.84	51, 750. 00	4.82	6, 780. 00
3.91	229, 810. 00	4.85	207, 375. 00
3.975	55, 645. 00	4.87	54, 967. 50
4.22	170, 500. 00	4.88	149, 000. 00
4.225	85, 250. 00	4.90	43, 375. 00
4.50	800, 000. 00	4.92	43, 250. 00
4.60	100, 890. 00	5.00	64, 000. 00
4.63	78, 250. 00	5.08	169, 000. 08
4.64	107, 932. 50	5.13	143, 627. 50
4.65	156, 000. 00	5.59	87, 977. 51
4.67	24, 465. 00	5.60	169, 434. 61
4.72	120, 750. 00	5.65	234, 243. 03
4.74	5, 167. 50	5.80	89, 375. 00
4.75	6, 020. 00	5.90	342, 704. 15
4.76	6, 860. 00	6.00	71, 251, 40
4.77	7; 715. 00		
4.78	22, 230. 00	Total	22, 076, 921. 45
4.79	17, 902. 50		

Supplemental life insurance data—Question D-5b—Mortgage loans made, year 1948 (by interest rate)

Month	Total			4 percent		4¼ percent		4½ percent		4¾ percent	
	Average rate	Number of loans	Amount	Number	Amount	Number	Amount	Number	Amount	Number	Amount
January	4.42	510	$3,069,424.59	248	$1,236,476.67	1	$40,000.00	171	$1,219,695.04	0	0
February	4.39	433	2,524,193.71	213	1,092,030.83	0	0	155	1,055,900.61	1	$5,200.00
March	4.40	309	2,649,911.65	119	933,496.32	2	126,577.45	117	1,197,864.39	6	28,600.00
April	4.52	209	1,217,082.60	65	372,699.96	0	0	84	561.539.18	2	8,000.00
May	4.49	138	1,559,342.21	38	197,917.58	0	0	67.	1,216,919.84	2	9,500.00
June	4.46	301	2,436,148.21	100	966,844.35	0	0	94	841,888.10	1	3,400.00
July	4.68	253	1,526,228.74	50	259,500.92	0	0	83	619,296.23	3	13,150.00
August	4.57	428	2,914,296.10	64	526,581.83	1	8,000.00	244	1,549,997.44	6	55,500.00
September	4.62	493	2,888,244.76	49	314,380.85	0	0	332	1,847,345.26	0	0
October	4.62	414	2,924,042.11	11	70,630.44	0	0	307	2,133,193.47	2	13,450.00
November	4.64	510	3,512,821.79	12	92,782.97	0	0	372	2,480,675.19	0	0
December	4.65	382	2,993,403.70	35	106,845.22	0	0	265	2,014,151.56	0	0
Total	4.54	4,380	30,214,140.17	1,004	6,170,187.94	4	174,577.45	2,291	16,738,466.31	23	136,800.00
Annual interest			1,372,020.94		246,807.52		7,419.54		753,230.98		6,498.00

Month	5 percent		5½ percent		6 percent		6½ percent		7 percent	
	Number	Amount	Number	Amount	Number	Amount	Number	Amount	Number	Amount
January	49	$394,939.24	38	$171,931.40	1	$3,972.41	0	0	2	$2,409.83
February	40	253,169.12	16	105,900.00	2	3,747.45	3	$5,157.82	3	3,087.88
March	47	279,123.49	18	84,250.00	0	0	0	0	0	0
April	32	141,543.46	26	133,300.00	0	0	0	0	0	0
May	28	119,204.79	3	15,800.00	0	0	0	0	0	0
June	75	466,362.53	31	157,653.23	0	0	0	0	0	0
July	90	509,329.30	20	95,324.36	5	22,764.50	2	5,863.43	0	0
August	93	661,253.35	14	76,093.41	6	36,870.07	0	0	0	0
September	77	526,397.27	16	102,988.16	19	97,133.22	0	0	0	0
October	82	650,859.20	7	33,622.61	5	22,286.39	0	0	0	0
November	104	831,828.74	12	62,828.25	10	44,706.64	0	0	0	0
December	69	787,387.74	8	55,851.09	5	29,168.09	0	0	0	0
Total	786	5,621,398.23	209	1,095,542.51	53	260,648.77	5	11,021.25	5	5,497.71
Annual interest		281,069.91		60,254.84		15,638.93		716.38		384.84

Average rate, 4.54 percent.

Supplemental life-insurance data—Question D-7—Form of investment contracts

	Owned Dec. 31, 1948	Acquired during 1948
Purchase and lease-back	$4, 419, 894. 21	$2, 395, 436. 56
Mortgage bonds	10, 269, 867. 60	3, 944, 954. 95
Debentures	3, 967, 540. 00	3, 075, 863. 75
Convertible (debentures)	1, 155, 691. 00	1, 155, 500. 00
Other bonds	25, 190, 823. 00	16, 557, 830. 06
Preferred stock	4, 266, 523. 00	1, 048, 851. 75
Common stock	24, 798, 260. 00	18, 596. 56
Total	74, 068, 598. 81	28, 197, 033. 63

Supplemental life-insurance data—Question E-2—Industrial securities purchased through underwriters, year 1948

Bonds:	
American Tobacco Co., sinking-fund debentures	$256, 093. 75
Dow Chemical Co., debentures	165, 060. 00
P. Lorillard Co., sinking-fund debentures	347, 485. 00
R. J. Reynolds Tobacco Co., debentures	830, 000. 00
Hiram Walker, Gooderham & Worts, Ltd., sinking-fund debentures	248, 125. 00
Westinghouse Electric Corp., convertible debentures	757, 500. 00
Total bonds	2, 604, 263. 75
Common stocks: Golden State Co., Ltd	16, 996. 56
Preferred stocks:	
Barker Bros. Corp., 4½ percent	12, 448. 38
Golden State Co., Ltd., 4-percent cumulative convertible	38, 253. 37
Hooker Electrochemical Co., $4.50 cumulative convertible, second preferred, series A	182, 700. 00
Total preferred stocks	233, 401. 75
Total	2, 854, 662. 06

The CHAIRMAN. Now, in conclusion, may I ask you to give your personal opinion, if you care to, in response to the questions that I addressed to you a moment ago, namely, whether the present trend is going too far with respect to the flow of investments to mature companies and large companies, and, secondly, what in your opinion are the capacities and abilities of a local or a State insurance company to serve small and local business as compared with larger insurance companies?

Mr. CLARKE. Well, that question really has several parts. I think, answering your first question as to whether the present trend has gone too far, that is something where economic forces and practical facts are almost compelling in their incidence. I do not think we can do very much about them. That is, it is the individuals or concerns, their credit standing, their progress—those things affect decisions, and I do not think you can do much about it. One concern will get a loan because the company it approaches finds a basis for a loan there. Perhaps that same applicant has gone to someone else and has been turned down. Well, it does not prove the second man is right and the first man is wrong. The second man may be sorry he made it.

On the other hand, he may see a very satisfactory loan work out and a very satisfactory relationship develop from the customer he took on that someone else turned down. That happened to me many times in my banking days and has happened also in insurance. It always gets back to the standing of the individual borrower or applicant and his know-how and all that.

Getting now to the second part of your question, I think—and here I am probably speaking against the interests of my own company—a surprisingly good job has been done by the largest of the life insurance companies, such as those that were represented here yesterday and others in the same general class, same general group, as to size.

I think they have done surprisingly well in distributing their loan resources around the country in various ways. We find them hot competition, to use the vernacular. They are competing on rates of interest, they are competing on terms, and the boys who are on the firing line will tell us they are pretty tough competition. We, of course, like to think a company like Occidental can do a better job right in California, and I think we can in many ways.

The CHAIRMAN. But the figures we have had presented here yesterday all indicate, as I pointed out, that applicants below $100,000, for example, particularly in the industrial and commercial field, are not quite able to meet the requirements of the larger companies. The figures for the 17 largest clearly show that.

Are you competing with them for the $100,000 loan and above, or do you fill in this area in which they apparently do not and have not successfully gone? Mr. Lincoln said yesterday that his company is anxious to get that sort of loan, so I am not criticizing the situation. I am merely saying that here is the fact.

Now, do you fill that gap, or do you not? Does the State company fill it, or does it compete with the big company for the big fellow's business?

Mr. CLARKE. We compete with them up to a point where we cannot take on something all by ourselves that they can, and then we fade out of that competition.

Coming down the scale, I think in our own local neighborhood we have an advantage because we are more accessible to the potential borrower than the company in New York, for example, so we do take care of some of them.

But to quote again the adage I used a moment ago, many are called but few are chosen. The smaller we go down, the more difficulty we have in picking, the more we look at in proportion to the ones we make, because the smaller borrower does not have the basis for sound credit in many instances and in many instances he is being taken care of by his bank.

I heard yesterday the remarks by Mr. Lincoln and the exchange between you about the local bank taking 10 percent of the risk if Mr. Lincoln's company would take the 90.

Not on exactly as formal a basis as that, but I have seen that happen where banks have referred fairly small applicants to us and have taken the short term part of the debt and we have made the longer term part.

The CHAIRMAN. Do you think that is a practicable plan?

Mr. CLARKE. It is in some instances, yes. I think development can be followed along that line to some degree.

The CHAIRMAN. Any questions, Mr. Herter?

Mr. HERTER. No.

The CHAIRMAN. Thank you very much, Mr. Clarke. We are greatly indebted to you for your presentation.

Mr. CLARKE. It has been a pleasure, sir.

STATEMENT OF JOSEPH M. BRYAN, FIRST VICE PRESIDENT, ACCOMPANIED BY JOHN ELLIS, RESEARCH DIRECTOR, AND M. H. CROCKER, ASSISTANT TREASURER, JEFFERSON STANDARD LIFE INSURANCE CO.

The CHAIRMAN. Mr. Bryan, I think I should say to you that Senator Graham sent word to me to express to you his regret at not being able to come to the meeting this morning to greet you personally. He speaks in the very highest terms of you and of the work you have been doing. Mr. Bryan, we will be very happy to have you proceed.

Mr. BRYAN. Mr. Chairman, my company, as you know, is the Jefferson Standard Life Insurance Co., located in Greensboro, N. C., and we are incorporated in that State. My name is Joseph M. Bryan, and I am first vice president and have been with the company about 20 years.

John Ellis is on my right. He is research assistant, and as of yesterday I promoted him to research director.

The CHAIRMAN. Congratulations, Mr. Ellis.

Mr. BRYAN. Mr. Scoll and Mr. O'Leary and Mr. Johnson have inundated me with questionnaires for the last few months, and from now on they are in Mr. Ellis' hands.

Mr. M. H. Crocker is assistant treasurer of the company, and he has been diverted from his normal duties in the last few months to do the job of research; and so he is here to help me interpret some of the figures.

The CHAIRMAN. May I say to Mr. Ellis that I sincerely hope the questionnaires of Mr. Scoll and Mr. O'Leary have resulted in giving you an increased salary as well as a more dignified title.

Mr. ELLIS. Thank you, sir.

Mr. BRYAN. Senator, I think you anticipated me a little, at least by a month.

The assets of the company at the end of 1948, December 31, were two-hundred-and-twenty-one-odd million, and they are presently about two hundred and forty. We operate in 30 States, the District of Columbia, and also Puerto Rico. That is, we are licensed to do business in those States.

We are, as you know, in the Southeast, primarily. It is a rapidly developing part of the territory, and I am sure you are all acquainted with the growth that has taken place in that area. The company itself has reflected some of that growth, and the best testimony I can give you on that is that in the last 20 years—it seems to be coincidental with my experience with the company—the assets have increased five times. It is purely coincidental.

With your permission, I will go ahead and read the prepared statement.

The CHAIRMAN. You may proceed.

Mr. BRYAN. Jefferson Standard welcomes the opportunity to participate in this hearing. The responsibility for managing the funds of over 300,000 policyholders requires that we give consideration to any question concerning investments.

Policyholders buy insurance for a number of reasons, but one important reason is that they have confidence in the investing ability of the life insurance companies. Life companies invest roughly $50,-

000,000 per working day, or some 64 cents per policyholder per day. However, of this amount only 20 cents per policyholder represents the investment of new funds as it is necessary to invest nearly $3 for every $1 of new money to keep the assets of companies invested fully at all times. This indicates the vast turn-over of insurance funds and how these funds need to be channeled to satisfy the constantly changing needs of our economy.

During the past several weeks we of Jefferson Standard have been tabulating information on our own investment activities which we hope will make some contribution to the present studies.

Our investments may be divided into five major categories: (1) Mortgage loans; (2) bonds; (3) common and preferred stocks; (4) real estate; and (5) collateral loans.

Mortgage loans represented 46 percent of our admitted assets and amounted to $101,000,000 at the close of 1948. Approximately 84 percent of the number of mortgage loans made were in original amounts of less than $15,000. This category represented about 33 percent of the total amount made. Over one-half of the amount of mortgage loans were commercial, business, and industrial mortgage loans.

Over 50 percent of the number of mortgage loans in this category were of original amounts of less than $15,000, and over 80 percent of the number were of original amounts of under $35,000. This latter classification accounted for 30 percent of the total amount in commercial, business, and industrial mortgage loans.

Single family residential mortgage loans were the second most important type of mortgage loan comprising 26 percent of the total amount of mortgage loans. In this classification, approximately 97 percent of the number of loans made were of original amounts of less than $15,000; and roughly 90 percent of the amount of these loans were in original amounts of less than $15,000.

Multifamily residential mortgage loans accounted for 7 percent of the total amount of mortgage loans outstanding. Sixty-six percent of the number of these loans were of original amounts of less than $15,000, and this classification accounted for about 28 percent of the total amount of multifamily residential mortgage loans.

Farm mortgage loans represented roughly 6 percent of the total amount of mortgage loans. Of the total number of farm mortgage loans made, over 78 percent were of original amounts of under $15,000. All other mortgages, such as hospital, lodge, and church mortgage loans, were relatively unimportant and accounted for less than $4,000,000.

Our bond account, amounting to $64,600,000, represented 38 percent of admitted assets.

Mr. HERTER. May I interrupt a moment, sir?

Mr. BRYAN. Yes, sir.

Mr. HERTER. I have been coming across the words "admitted assets." What does the word "admitted" mean?

Mr. BRYAN. Admitted assets is that which the insurance commissioners prescribe as being admitted. There are certain deductions of minor character such as agents' balances or excess loans. I think that is about the complete category. I could itemize them for you. I have them here.

Mr. HERTER. I was not familiar with the term.

Mr. BRYAN. They are of a minor nature. It is probably a misleading term, too.

The CHAIRMAN. It is not like a defendant acknowledging something that is bad, is it?

Mr. BRYAN. No.

The CHAIRMAN. It is merely a recitation of what the insurance commissioners will permit you to claim?

Mr. BRYAN. Yes, sir.

The CHAIRMAN. In other words, the admission is by the commissioner and not by the insurance company.

Mr. BRYAN. No; that is not true. I think we also conform to that practice because, as I say, the word is misleading in that they call it admitted, but it actually is admitted as assets on the balance sheet and should be called assets. In normal banking terms they are the assets.

The CHAIRMAN. There are deductions from the claimed assets of the insurance company?

Mr. BRYAN. Yes, sir.

The CHAIRMAN. In other words, the insurance commissioners disallow certain claims?

Mr. BRYAN. That is right, sir. The two major types of bonds in this account are: (1) United States Government bonds, which account for 53 percent of the bond account; and (2) industrial bonds, which account for 43 percent of the bond account. Virtually all of of the industrial bonds are bonds that have been privately placed. For the year 1948, Jefferson Standard ranked seventh among all companies in the total number of private placements and fourteenth in the total amount of private placements in amount. The majority of our private placements have been with relatively small businesses as, during the period from 1936 through 1948, 80 percent of the number and 43 percent of the total amount of private placements were of original amounts of $500,000 and under.

This is further established by the fact that 42 percent of the borrowers, whose loans were outstanding at the end of 1948, had assets of less than $1,000,000; and about 63 percent of the borrowers had assets of less than $4,000,000.

During the period from 1936 through 1948, Jefferson Standard made 138 private placements which totaled $60,800,000. The largest loan was made $4,000,000, while the smallest loan made was $25,000. The average size of the private placements was $377,424.06. The average maturity was just a little less than 15 years.

At the close of 1948, the total common and preferred stock holdings of Jefferson Standard amounted to about $19,500,000, or slightly less than 9 percent of admitted assets. The common stock owned, amounting to nearly $12,000,000, represented 5.4 percent of admitted assets, whereas preferred stock holdings represented nearly 3.5 percent.

Of the total stock owned, industrial and miscellaneous stocks accounted for roughly 52 percent, banks and insurance companies accounted for about 36 percent, public utility stocks represented about 10.5 percent, and railroad stocks represented 1.5 percent.

Since North Carolina law permits life companies to invest a maximum of 4 percent of admitted assets in sale and lease-back of real estate, Jefferson Standard has explored the field with much interest.

At the close of 1948 Jefferson Standard held 3.3 percent of its admitted assets, or about $7,400,000, in this type real estate investment. The largest single item held was an amount of roughly $1,170,000. The smallest item was an amount of $23,900. The average size of these real estate holdings was $217,559.68.

The fifth and last type of investment is collateral loans, a small item, as you can see. At the close of 1948 collateral loans represented only six-tenths percent of admitted assets and a total amount of $1,350,000. The average size of collateral loans was $193,878.71. The largest amount was about $500,000 and the smallest amount was $30,000.

In closing I would like to emphasize that although admitted assets have increased only five-fold since 1929, Jefferson Standard has continued to serve the monetary needs of a wide range of economic units—both corporates and individuals. We have never considered limiting our investments to any particular segment of the economy regardless of size or type. Our policy has been dictated by prudence alone. In company with other life-insurance companies, we feel over the years the record has been a good one.

(Prepared answers to questions propounded in sec. B, item 1, appendix A, of Factors Affecting Stability of Private Investment, with text and charts covering supplemental life insurance data requested, and additional charts, submitted are as follows:)

Answers Supplied by Joseph M. Bryan, First Vice President of Jefferson Standard Life Insurance Co., to Questions Suggested in Factors Affecting Volume and Stability of Private Investment

I. PORTFOLIO MANAGEMENT

(*a*) At the present time we are permitted to have 4 percent of our admitted assets in sale and lease-back real estate. We feel that this type of investment is well suited for life-insurance companies for a number of reasons: First, the yield is more or less fixed in dollar amounts which is desirable from our viewpoint because our obligations are fixed dollar obligations; second, these investments are not subject to daily market fluctuations which reflect a large degree of speculative psychology; valuation of such investment can be made on more of an intrinsic-value basis; third, in making this form of investment life companies are supplying equity capital; fourth, these investments yield a rate of return more in keeping with the rate which we have contracted to earn for our policyholders. Therefore, we feel that we would increase the portion of our funds that are invested in sale and lease-back real estate, if the laws were modified to permit it.

If a more suitable method of valuing stocks could be approved so that our carrying values would not reflect temporary shifts in investors' psychology we would probably increase the portion of funds invested in stocks. We hold this belief because of the following reasons: First, the percentage of total savings going to life companies is increasing; second, many companies have only stock outstanding and because of restrictions against this form of investment, life companies have been deprived of the opportunity of investing in many corporations; third, past records have displayed that, adjusting for profits and losses on disposal of securities, stocks have provided a higher return than fixed-interest-bearing investments.

(*b*) Yes. In the case of private placements it has been our practice to set a minimum amount of $100,000. This has been dictated by the legal costs involved in writing the indenture and in the personnel costs involved in investigating and framing such financing along tailor-made lines. Amounts smaller than this minimum are considered on a mortgage loan basis. For single-family residential mortgage loans, our minimum has been $2,500. Any property having a mortgage value less than this amount we consider too marginal under present-day inflated values.

(*c*) North Carolina laws limit investment in the stock of any one corporation to 3 percent of life company admitted assets. We have never been hampered by this regulation as we consider that the standard established is proper. Other than this regulation, Jefferson Standard has no maximum amount prescribed as a guide. We have simply followed a policy of prudence which allows flexibility in judging particular situations.

II. FIXED INTEREST DEBT OBLIGATIONS

(*a*) The railway industry is always cited as the prime example of an industry generally underequity. capitalized. However, Jefferson Standard has found no other particular industry with a shortage of equity capital. We have seen some individual companies in such situations but they do not exist entirely in one industry and are widely scattered among unrelated industries.

(*b*) There is no single rule-of-thumb debt-equity ratio followed by Jefferson Standard. It is our opinion that this ratio should not only vary with different industries but should also vary with individual companies within a single industry. In analyzing a company's debt-equity ratio we give considerable attention to: (*a*) the company's degree of sales fluctuation; (*b*) the flexibility of operating expense; and (*c*) the stability of earnings. These factors are important in indicating the funds that will be available to service the fixed charges and are more important considerations than any one rule-of-thumb ratio.

(*c*) During recent years our economy has been enjoying a prosperous era. In such times the standards for proper debt-equity ratios are generally raised because a concern that cannot adequately strengthen its financial structure in prosperous periods will probably experience extreme difficulty in meeting its fixed charges in depressed periods. In turn, there is the opposite tendency during depressed periods, namely to relax debt-equity standards. Our policy has been to follow this reasoning to a limited degree recognizing that the chief limitation in the reasoning is the difficulty of forecasting business conditions.

(*d*) (1) No.

(2) I am not convinced that there is a shortage of equity funds. Taking the figures from the monograph, Factors Affecting Volume and Stability of Private Investment, it is observed that stockholders' equity represented 64.3 percent of the capitalization of manufacturing corporations and 55 percent of the capitalization of trading corporations. These over-all figures do not indicate that such a shortage exists. Furthermore, it is my opinion that the above-mentioned percentages would be substantially increased if prospective profits were more commensurate with the risks assumed.

III. PRIVATE PLACEMENTS

(*a*) (1) The private placements made by Jefferson Standard have been initiated usually by the borrower or an intermediary. In a few instances the company has approached a prospective borrower for the purpose of persuading him to borrow funds. During the past few years we estimate 60 percent of the private placements have come to us through intermediaries and 40 percent directly from the borrower.

(2) Jefferson Standard employs the usual methods of supervising or controlling the debtor's use of funds that are employed by other insurance companies and by commercial banks in their term loans. The protective provisions generally employed are: (*a*) working capital or current ratio minimum; (*b*) no stock to be purchased or retired without our consent; (*c*) no dividends to be paid to stockholders except from subsequent earnings; and (*d*) no additional funded debt to be created without our consent. A covenant to maintain adequate fire insurance and to allow no loans to officers is provided in nearly every issue. The company also requires that yearly audits be submitted for examination. Other than as above the company does not restrict the management of the borrowing corporations.

(*b*) Bonds acquired through direct-placement are subject to the same valuation procedures as issues acquired in the market in that values established by the National Association of Insurance Commissioners are used.

IV

(*a*) North Carolina law permits life-insurance companies to invest in stocks up to 10 percent of their admitted assets. At the close of last year Jefferson Standard had 8.8 percent of its admitted assets invested in stocks of which 5.4 percent of admitted assets were invested in common stocks. The primary reason Jefferson Standard did not have the maximum amount permitted is the fact that a number of our private placements are made in preferred stocks. Since the company has no method of predicting when a borrower will approach the company with a request for such funds we have made it our policy to hold between 8 and 9 percent of our portfolio in stocks in order that we may be able to meet such requests of our borrowers.

(*b*) Common stocks are valued at the lower of cost or the market value set by the National Association of Insurance Commissioners.

(*c*) All three of these factors were responsible for Jefferson Standard's decision to invest in common stocks. The first two—search for suitable use of funds and relative attractiveness on an earnings basis—were the more important considerations.

(*d*) (1) The company's policy with respect to voting has been to vote with management. Before purchasing common stocks we satisfy ourselves that the management is able. Thereafter, we vote with the management having in mind that they are competent and have studied the issue thoroughly before expressing their viewpoint. (2) Before a common stock is purchased, an extensive analysis is made of the company's position. This analysis along with the yearly reports is reviewed and studied periodically.

V. DIRECT INVESTMENT—RESIDENTIAL AND COMMERCIAL REAL ESTATE

(*a*) North Carolina law distinguishes between sale and lease-back real-estate investment and purchases of residential or commercial real estate. The law does not permit life companies to buy residential or commercial real estate for investment. It does permit investment of 4 percent of admitted assets in sale and lease-back real estate. At December 31, 1948, Jefferson Standard held $7,397,029,38, or 3.3 percent of its admitted assets, in the latter form.

VI. SALE AND LEASE-BACK

(*a*) This form of investment was developed largely by the lessee who realized the advantages of leasing his plant rather than tying up his capital in fixed investment. By selling his plant and leasing it back the lessee is able to increase his working capital. While life companies have attempted to point out the advantages of the sale and lease-back arrangement the prospective lessee has been the instigating force.

(*b*) The typical lease employed by Jefferson Standard provides for a fixed monthly rental for a period of 15 to 25 years. The lessee is required to pay all property taxes and maintain adequate insurance covering the property. Default on the contract is brought about when: (1) the lessee fails to pay the rental in full within 15 days after written notice; (2) the lessee fails to pay the taxes or insurance premiums within 30 days after written notice. When such default occurs the lessor may sublet the property until default is corrected. The expenses involved in subletting and any difference in contracted rental and rental realized from subletting must be paid by the lessee.

(*c*) The main point of difference is that in the case of default in a debenture agreement the principal and interest are immediately due from the borrower. In a lease-back arrangement the lessor cannot accelerate the rental payments due over the term of the lease, but can take possession of the property and sublet and hold the lessee responsible for expenses and costs as stated previously.

(*d*) We regard these sale and lease-back investments as business equities since title to the property remains in Jefferson Standard after the termination of the lease.

VII

(*a*) I have not had sufficient time to devote to the study of the solution of this problem. I realize the magnitude and scope of this subject and regret that I have so little to contribtue.

However, I fail to visualize how the life-insurance business can undertake any organized effort to stabilize private investment expenditures. By the very nature of competitive business it is precluded from making any organized effort as this would be contrary to public policy.

Financial institutions have little control over the origination of funds entrusted to them by individuals. Therefore, as long as these institutions remain fully invested there is little beyond this that they can do. The record of life-insurance companies in maintaining a minimum of cash and of banks in maintaining a minimum of excess reserves reveals that these institutions do keep their investable funds employed at all times.

(*b*) There is no program for timing direct investments followed by Jefferson Standard. We have no control over the demand for this form of credit and, as pointed out previously, such investments almost always come from the borrower. Neither does Jefferson Standard have any program for timing the amounts that we will lend under this form of investment at the varying positions of the business cycle.

(*c*) Governmental policies can detrimentally influence investment expenditures if they include progressively rising taxes which reduce the net return in business enterprise thereby increasing the risk in any contemplated additional expenditures for plant and equipment, inventories, and developmental outlays. As was thoroughly treated in the monograph, any failure on the part of government to allow adequate depreciation would also be a detrimental factor to investment expenditures. When old equipment cannot be replaced because of inadequate scheduling of depreciation, governmental policies toward depreciation allowances should be changed. One method that would help stabilize capital expenditures for plant and equipment would be to allow a sliding depreciation scale. When expenditures for plant and equipment turn downward a slightly accelerated depreciation program should be allowed. This would be returned to normal amounts when expenditures on such items increased to the desired level. The degree of acceleration allowed should be determined by the degree of decline in expenditures on plant and equipment and the amount of acceleration needed to increase expenditures for plant and equipment.

(*d*) Governmental expenditures may properly be employed to complement business investment expenditures but should largely be confined to activities and enterprises having desirable social objectives which are not sought or attained by competitive business.

SUPPLEMENTAL LIFE INSURANCE DATA SUPPLIED BY JOSEPH M. BRYAN, FIRST VICE PRESIDENT OF JEFFERSON STANDARD LIFE INSURANCE CO. FOR THE INVESTMENT SUBCOMMITTEE OF THE JOINT COMMITTEE ON THE ECONOMIC REPORT, DECEMBER 8, 1949.

Question A

The executive committee of Jefferson Standard attempts to evaluate over-all economic trends annually. These estimations are altered during the course of the year as may be necessary to conform with current conditions. From this basic evaluation investment policy relative to particular industries is formulated to a certain degree. These forecasts are applied in estimating the future of a particular enterprise; however, we do not feel that a negative forecast of an industry disqualifies all of the securities in the industry. It is our opinion that any investment analysis must be focused on the particular enterprise and its particular situation rather than relying solely on the industry forecast. Although, we pointed out previously, the industry forecast is applied primarily in estimating such items as sales and labor costs.

(1) There is no coordination among life companies to establish investment policy relative to particular industries. This fact may be observed by examining the portfolios of several companies. For example, Jefferson Standard had almost 9 percent of its admitted assets in stocks whereas the industry percentage as a whole was less than 3 percent. The only coordination among life companies in investments in any respect is in those instances where a privately placed issue is too large for one company to assume and other companies are invited to share in the issue.

(2) Yes. Our pattern of applying these factors is along the following lines. In our industry analyses, the sales estimations are based on forecasts of prices and of quantity volume. The price policies of the industry that have been followed in the past are examined carefully to appraise what the future may hold. These factors are studied in relation to present demand and supply forces to arrive at the ultimate conclusion of prices, sales, and finally profits. The prospective borrower's particular situation is reviewed along this line with the basic industry forecast as a guide.

Question B.—Geographical distribution of insurance in force and total investments (excluding Government bonds) of Jefferson Standard Life Insurance Co., Dec. 31, 1948

Territory	Insurance in force	Total investments (excluding Governments)
Alabama	$24, 638, 732	$3, 572, 223. 28
Alaska		191, 250. 00
Arizona	3, 000, 358	4, 825, 865. 43
Arkansas	9, 945, 440	1, 931, 313. 98
California	23, 210, 938	14, 243, 494. 37
Colorado	6, 194, 211	43, 200. 00
Connecticut		108, 025. 00
Delaware	905, 072	2, 923, 161. 00
District of Columbia	8, 132, 171	452, 572. 24
Florida	28, 685, 215	14, 420, 655. 40
Georgia	40, 195, 424	6, 749, 526. 35
Idaho	482, 684	
Illinois	3, 497, 304	3, 501, 528. 75
Indiana	2, 998, 572	2, 267, 714. 00
Kansas	2, 864, 987	107, 012. 50
Kentucky	20, 482, 329	6, 406, 233. 16
Louisiana	18, 610, 720	4, 226, 629. 31
Maine		148, 475. 00
Maryland	16, 516, 259	1, 038, 161. 19
Massachusetts		657. 738. 32
Michigan		302, 441. 46
Minnesota		102, 000. 00
Mississippi	16, 445, 861	3, 457, 992. 23
Missouri	$2, 725, 382	$1, 006, 320. 05
Montana		12, 500. 00
New Jersey		3, 384, 236. 19
New Mexico	4, 221, 881	2, 751, 358. 03
New York		6, 569, 933. 75
North Carolina	234, 390, 369	27, 149, 366. 11
Ohio	7, 348, 311	2, 321, 641. 17
Oklahoma	16, 569, 329	4, 995, 299. 63
Oregon	156, 823	1, 250, 000. 00
Pennsylvania	15, 519. 368	2, 266, 018. 50
South Carolina	41, 236, 775	6, 506, 388. 59
Tennessee	31, 486, 434	9, 091, 280. 84
Texas	126, 533, 561	17, 657, 135. 12
Utah		84, 502. 00
Virginia	43, 608, 672	4, 667, 854. 34
West Virginia	25, 389, 002	819, 021. 61
Wyoming	2, 910, 040	
Washington	428, 509	5, 000. 00
Puerto Rico	15, 519, 747	805, 022. 44
Reinsurance	3, 484, 232	
Miscellaneous	22, 390, 564	
Total	820, 725, 276	162, 520, 992. 20

Question C—Investment portfolio of Jefferson Standard Life Insurance Co., Dec. 31, 1948

Classification of investments		Total amount	Percent of admitted assets
Manufacturing		$12, 831, 592. 58	5. 8
Trade		25, 220, 397. 32	11. 4
Electricity, gas, water and telephone		2, 925, 620. 06	1. 3
Railroads		615, 185. 55	. 2
Other transportation		242, 437. 50	. 1
Single family residential real estate mortgages		27, 002, 131. 04	12. 2
Multi-family residential real estate mortgages		7, 791, 867. 48	3. 5
Multi-family real estate direct investments		0	0
Mortgages on commercial real estate held for rental purposes		56, 612, 901. 66	25. 5
Mining, including oil and gas		271, 022. 50	. 1
U. S. Government securities		34, 312, 930. 73	15. 5
States and Municipals		735, 413. 24	. 3
States	$215, 595. 21		
Municipals:			
Public improvement	144, 670. 42		
Street improvement	112, 313. 04		
Jail	1, 993. 94		
Water	66, 977. 40		
Funding and refunding	130, 941. 02		
Auditorium	3, 311. 10		
School	52, 623. 17		
Electric light	6, 987. 94		
Total		168, 561, 499. 66	75. 9

Question D—Part 1—Geographical location of industrial investments of Jefferson Standard Life Insurance Co., Dec. 31, 1948

	Total amount invested		*Total amount invested*
Alabama	$1,934,620.62	Montana	$12,500.00
Arizona	2,913,315.00	New Jersey	2,917,664.19
Arkansas	1,434,945.00	New Mexico	846,623.13
California	8,346,197.90	New York	6,073,522.75
Delaware	2,641,873.50	North Carolina	17,992,593.99
District of Columbia	447,500.00	Ohio	1,888,878.96
Florida	10,346,482.12	Oklahoma	2,946,059.28
Georgia	5,030,045.45	Oregon	1,250,000.00
Illinois	3,370,253.75	Pennsylvania	2,165,371.31
Indiana	1,781,750.00	Puerto Rico	457,179.98
Kentucky	6,074,866.77	South Carolina	5,960,662.01
Louisiana	1,951,945.93	Tennessee	5,822,733.07
Maine	55,800.00	Texas	6,240,737.82
Maryland	895,169.86	Virginia	2,144,498.24
Massachusetts	657,738.32	West Virginia	390,018.35
Michigan	302,441.46		
Mississippi	897,944.65	Total	[1] 103,748,254.05
Missouri	567,633.95		

[1] This total includes industrial bonds; business, commercial, and industrial mortgage loans; industrial real-estate investments; industrial preferred and common stocks; and industrial collateral loans.

Question D—Part 2—Total commercial, business, and industrial mortgage loans held by Jefferson Standard Life Insurance Co., Dec. 31, 1948

Size of mortgage	Cumulative percent of total	Percent of total number	Number	Total original amount	Percent of total amount	Cumulative percent of total
Under $5,000	13.4	13.4	298	$1,009,845.22	1.4	1.4
$5,000 to $15,000	53.7	40.3	896	7,588,125.03	10.2	11.6
$15,000 to $35,000	82.4	28.7	637	13,563,330.96	18.2	29.8
$35,000 to $100,000	94.0	11.6	258	13,307,325.85	17.8	47.6
$100,000 to $500,000	99.2	5.2	116	22,545,598.00	30.2	77.8
$500,000 to $1,000,000	99.7	.5	11	7,548,000.00	10.1	87.9
$1,000,000 and over	100.0	.3	6	9,100,000.00	12.1	100.0
Total			2,222	74,662,225.06	100.0	

Private placements of Jefferson Standard Life Insurance Co., by size, 1936–48

Size of loan	Cumulative percent of total	Percent of total number	Number	Total original amount	Percent of total amount	Cumulative percent of of total
$100,000 and under	21.7	21.7	30	$1,997,661.95	3.4	3.4
$100,001 to $200,001	39.1	17.4	24	3,738,291.72	6.1	9.5
$200,001 to $500,001	80.4	41.3	57	20,324,449.28	33.4	42.9
$500,001 to $1,000,001	92.4	12.3	17	12,285,000.00	20.2	63.1
Over $1,000,000	100.0	7.3	10	22,468,750.00	36.9	100.0
Total		100.0	138	60,814,152.95	100.0	

Question D—Part 3.—Type of product or service of industrial investments of Jefferson Standard Life Insurance Co., Dec. 31, 1948

Classification	Industrial bonds		Business, commercial and industrial mortgage loans		Investment real estate		Stocks		Total	
	Gross	Net	Gross	Net	Gross	Net	Gross	Net	Gross	Net
Newspapers	$18,405,000	$13,492,625.00					$421,987.50	$421,987.50	$18,826,987.50	$13,914,612.50
Textiles	3,675,000	2,940,000.00					3,678,270.16	3,663,768.35	7,353,270.16	6,603,768.35
Bakeries	785,000	722,200.00							785,000.00	722,200.00
Schools and colleges	1,400,000	1,340,000.00							1,400,000.00	1,340,000.00
Glass manufacturers	500,000	500,000.00					49,600.00	40,000.00	549,600.00	540,000.00
Laundries	1,365,000	868,750.00	$828,750.00	$645,541.57	$2,059,080.68	$1,809,860.68			4,252,830.68	3,324,152.25
Finance companies	2,413,750	2,303,809.72							2,413,750.00	2,303,809.72
Radio stations	1,510,000	1,287,500.00					956,599.49	956,599.49	2,466,599.49	2,244,099.49
Metal fabricators	1,326,000	1,321,561.31					532,583.25	524,483.25	1,858,583.25	1,846,044.56
Auto accessories	250,000	212,500.00							250,000.00	212,500.00
Dairies and dairy products	1,145,000	942,500.00					94,587.50	92,200.00	1,239,587.50	1,034,700.00
Hotels	415,000	95,000.00	30,732,764.58	23,725,627.70			107,500.00	107,500.00	31,255,264.58	23,928,127.50
Furniture manufacturers	1,850,000	1,753,275.00					107,159.60	106,930.00	1,957,159.60	1,860,205.00
Garages and service stations			2,935,900.00	2,316,090.23					2,935,900.00	2,316,090.23
Cafes			795,570.00	648,539.85					795,570.00	648,539.85
Office building			6,977,900.00	5,179,257.00	1,545,550.66	1,282,211.66			8,523,450.66	6,461,468.66
Mortuaries			622,500.00	393,113.98					622,500.00	393,113.98
Business stores			24,069,265.48	17,734,848.89					24,069,265.48	17,734,848.89
Theaters			1,633,000.00	991,108.53	1,627,513.22	1,365,454.22			3,260,513.22	2,356,562.75
Ice plants			534,000.00	455,296.38					534,000.00	455,296.38
Chemicals and drugs							391,923.04	348,924.54	391,923.04	348,924.54
Tobacco							584,790.01	518,325.00	584,790.01	518,325.00
Confectionary							98,850.00	88,600.00	98,850.00	88,600.00
Soft drinks							135,961.50	135,961.50	135,961.50	135,961.50
Petroleum							265,337.50	258,522.50	265,337.50	258,522.50
Construction and building material							159,177.90	154,552.90	159,177.90	154,552.90
Paper							76,745.50	71,750.00	76,745.50	71,750.00
Hardware							197,557.50	196,127.50	197,557.50	196,127.50
Food and retail groceries							1,095,196.20	1,028,905.20	1,095,196.20	1,028,905.20
Tire and rubber							61,688.94	61,688.94	61,688.94	61,688.94
Tourist courts and motels			3,385,375.00	2,904,460.53					3,385,375.00	2,904,460.53
Retail department stores							242,619.00	238,618.00	242,619.00	238,618.00
Miscellaneous	470,200	434,875.00	2,147,200.00	1,658,739.21	3,389,309.63	2,939,502.82	1,189,876.45	1,111,408.20	7,196,586.08	6,144,525.23
Total	35,509,950	28,214,596.03	74,662,225.06	56,652,623.87	8,621,454.19	7,397,029.38	10,448,023.04	10,126,853.87	129,241,652.29	102,391,103.15

Question D—Part 4—Purpose of industrial bond private placements of Jefferson Standard Life Insurance Co., Dec. 31, 1948

Purpose	Percent of total number	Number	Unpaid balance Dec. 31, 1948	Percent of total unpaid balance
New expansion	28.9	20	$6,554,025.00	23.3
Purchase—expansion	23.2	16	6,690,750.00	23.8
Refunding	14.5	10	2,242,059.72	8.0
Working capital	17.4	12	2,860,250.00	10.2
Refunding and expansion	10.2	7	6,693,450.00	23.9
Expansion and working capital	2.9	2	1,128,000.00	4.0
Refunding and working capital	2.9	2	1,925,000.00	6.8
Total	100.0	69	28,093,534.72	100.0

Question D—Part 5—Rate of interest on all private placements held by Jefferson Standard Life Insurance Co., Dec. 31, 1948

Rate of interest (percent)	Percent of total number	Number of loans	Total amount	Percent of total amount
3	1.28	1	$55,000.00	.18
4	5.13	4	5,738,559.72	18.34
4.25	2.56	2	1,100,000.00	3.51
4.50	19.23	15	8,805,675.00	28.14
4.75	3.85	3	830,000.00	2.65
5	58.97	46	12,716,950.00	40.63
5.50	5.13	4	651,750.00	2.08
6	3.85	3	1,398,375.00	4.47
Total	100.0	78	31,296,309.72	100.0

Question D—Part 5—Rate of interest on commercial, business, and industrial mortgage loans of Jefferson Standard Life Insurance Co., Dec. 31, 1948

Interest rate (percent)	Number loans	Original amount	Balance
4	23	$4,656,945.22	$3,815,972.65
4.25	4	4,248,500.00	3,925,506.25
4.50	142	13,945,947.06	10,972,187.85
5	1,182	39,974,652.93	30,949,755.14
5.25	1	200,000.00	140,250.00
5.5	199	2,829,000.00	2,382,378.52
6	663	8,699,679.85	4,414,210.46
6.50	5	57,500.00	32,758.00
7	3	50,000.00	19,605.00
Total	2,222	74,622,225.06	56,652,623.87

Question D—Part 7—Form of industrial investment contracts, by gross and net amounts, of Jefferson Standard Life Insurance Co., Dec. 31, 1948

Form of contract	Gross	Net
Purchase and lease-back	$8,619,899.66	$7,397,029.38
Mortgage bonds	29,021,200.00	22,312,611.31
Debentures	5,220,000.00	4,720,734.72
Convertible bonds	0	0
Collateral trust bonds	1,268,750.00	1,181,250.00
Preferred stock	6,400,898.06	6,229,283.89
Common stock	4,047,124.98	3,897,569.98
Total	54,577,872.70	45,738,479.28

Question E

1. Direct industrial loans (listed on books at Dec. 31, 1948):	
(*a*) By individual companies	$18,861,325.00
(*b*) By more than one company in collaboration	11,947,425.00
(*c*) With banks and other lending institutions	237,559.72
Total industrial private placements	31,046,309.72
2. Industrial security purchases through underwriters of issues held Dec. 31, 1948:	
Bonds	121,061.31
Preferred stocks	3,276,508.89
Common stocks	2,330,840.66
Total	5,728,410.86

Question F

The large amount of money in circulation plus the fact that Government obligations are being marketed at low rates are the overriding factors contributing to the present low rate of interest. The large demand by life-insurance companies for fixed-interest-bearing obligations is a contributing force, but it is often negligible when compared to the pressure exerted by the rate on Government securities.

Question G

In analyzing a loan application, major attention is devoted to appraising the borrower's over-all position throughout the entire repayment period. The most important consideration, of course, is earnings and the adequacy of the earnings to service the interest and principal payments. However, asset valuations and asset-to-debt ratios are considerations, since the assets may be the last resort for repayment as well as a determining factor in the earning ability of the borrower. Therefore, it is necessary to appraise the valuation and depreciation methods in lieu of what the assets are actually worth currently and what they may be worth throughout the repayment period. It is at this point that careful consideration is given to present prices and probable future prices of inventories and fixed assets. In this step an attempt is made to estimate the minimum price to which these assets may shrink.

(Additional charts submitted by Mr. Bryan are as follows:)

Selected data on stocks of Jefferson Standard Life Insurance Co., 1936–48

	Total amount of common and preferred stock purchased	Total number of stocks purchased	Average size purchased	Maximum amount purchased [1]	Minimum amount purchased [1]	Total amount of private placements in stocks	Total number of stocks purchased	Average size purchased	Maximum amount purchased	Minimum amount purchased
1948	$4, 376, 904. 29	67	$65, 326. 92	$221, 987. 50	$4, 800. 00	$900, 000. 00	2	$450, 000. 00	$600, 000	$300, 000. 00
1947	2, 672, 235. 08	35	76, 349. 57	349, 698. 00	860. 20	525, 000. 00	2	262, 500. 00	500, 000	25, 000. 00
1946	6, 064, 275. 35	26	233, 241. 34	1, 286, 901. 00	1, 564. 00	1, 875, 325. 00	3	627, 441. 66	1, 600, 000	75, 000. 00
1945	8, 128, 011. 15	26	312, 615. 81	4, 968, 620. 00	782. 00	1, 294, 041. 72	3	431, 347. 24	750, 000	100, 791. 72
1944	2, 566, 466. 65	16	160, 404. 16	1, 525, 000. 00	1, 148. 00	355, 000. 00	2	177, 500. 00	257, 500	97, 500. 00
1943	992, 991. 07	23	43, 173. 52	200, 133. 33	660. 00	150, 000. 00	1	150, 000. 00	150, 000	150, 000. 00
1942	1, 570, 304. 25	40	39, 257. 60	307, 600. 00	1, 800. 00	300, 000. 00	1	300, 000. 00	300, 000	300, 000. 00
1941	1, 230, 582. 73	40	30, 764. 56	346, 250. 00	612. 00	0	0	0	0	0
1940	1, 785, 703. 00	39	45, 787. 25	113, 535. 00	512. 50	500, 000. 00	2	250, 000. 00	350, 000	150, 000. 00
1939	1, 685, 953. 28	25	67, 438. 13	408, 644. 64	400. 00	400, 000. 00	1	400, 000. 00	400, 000	400, 000. 00
1938	404, 556. 32	14	28, 896. 88	192, 500. 00	450. 00	0	0	0	0	0
1937	759, 240. 40	12	63, 270. 03	97, 000. 00	500. 00	525, 000. 00	2	262, 500. 00	350, 000	175, 000. 00
1936	648, 355. 56	9	72, 039. 50	200, 460. 00	3, 500. 00	279, 500. 00	2	139, 750. 00	217, 000	62, 500. 00
1936–48	32, 885, 579. 13	372	88, 402. 09	4, 968, 620. 00	400. 00	7, 103, 866. 72	21	338, 279. 36	1, 600, 000	25, 000. 00

[1] Excludes private placements.

Selected data on stock holdings of Jefferson Standard Life Insurance Co., 1936–48

	Total amount of common and preferred stock owned	Percent of admitted assets	Total preferred stock owned	Percent of admitted assets	Total common stock owned	Percent of admitted assets
1948	$19, 544, 373. 58	8. 8	$7, 554, 889. 31	3. 4	$11, 989, 484. 27	5. 4
1947	17, 152, 765. 50	8. 6	6, 111, 059. 52	3. 1	11, 041, 605. 98	5. 5
1946	16, 035, 568. 14	8. 9	5, 824, 326. 00	3. 2	10, 211, 242. 14	5. 7
1945	14, 494, 615. 60	8. 9	5, 965, 133. 71	3. 6	8, 529, 481. 89	5. 3
1944	8, 835, 827. 19	6. 2	4, 566, 540. 52	3. 3	4, 269, 286. 67	2. 9
1943	7, 255, 908. 41	5. 6	4, 146, 881..29	3. 2	3, 109, 027. 13	2. 4
1942	6, 981, 841. 96	6. 1	3, 940, 270. 09	3. 5	3, 041, 571. 87	2. 6
1941	5, 652, 597. 48	5. 4	3, 228, 073. 97	3. 1	2, 424, 523. 51	2. 3
1940	6, 656, 238. 36	7. 0	2, 770, 489. 06	2. 9	3, 885, 749. 30	4. 1
1939	6, 244, 668. 34	7. 1	1, 691, 797. 40	1. 9	4, 552, 870. 94	5. 2
1938	4, 653, 334. 80	5. 8	1, 113, 777. 76	1. 4	3, 539, 556. 04	4. 4
1937	4, 268, 613. 32	5. 8	1, 094, 119. 88	1. 5	3, 174, 493. 44	4. 3
1936	4, 417, 771. 57	6. 5	1, 162, 764. 88	1. 7	3, 255, 006. 69	4. 8
1936–48	----------------	7. 0	----------------	2. 8	----------------	4. 2

Selected data on common-stock holdings of Jefferson Standard Life Insurance Co., 1936–48

	Total amount of common stock purchased	Total number of stocks purchased	Average size	Maximum amount	Minimum amount	Total common stock held as a percent of admitted assets	Rate of interest earned on common-stock portfolio	
							Dividends only	Dividends adjusted[1]
						Percent	*Percent*	*Percent*
1948	$2, 305, 600. 79	48	$47, 616. 66	$221, 987. 50	$4, 800. 00	5. 4	6. 12	6. 70
1947	1, 105, 440. 08	20	55, 272. 00	349, 698. 00	860. 20	5. 5	5. 58	5. 59
1946	4, 027, 496. 35	20	201, 374. 81	1, 286, 901. 68	1, 564. 00	5. 7	2. 50	2. 50
1945	5, 448, 137. 50	12	454, 011. 45	4, 968, 620. 00	782. 00	5. 3	2. 53	33. 38
1944	1, 718, 866. 00	7	245, 552. 28	1, 525, 000. 00	1, 148. 00	2. 9	4. 96	4. 95
1943	155, 041. 50.	9	17, 226. 82	85, 600. 00	660. 00	2. 4	6. 25	6. 25
1942	444, 305. 00	11	40, 391. 36	141, 862. 50	1, 800. 00	2. 6	5. 49	5. 49
1941	500, 748. 50	13	38, 519. 11	346, 250. 00	612. 00	2. 3	6. 96	. 25
1940	315, 265. 50	7	45, 037. 92	107, 000. 00	512. 50	4. 1	5. 33	4. 30
1939	1, 014, 843. 14	16	63, 427. 69	408, 644. 64	400. 00	5. 2	3. 59	3. 60
1938	335, 181. 10	10	35, 518. 11	192, 500. 00	450. 00	4. 4	3. 62	3. 58
1937	137, 240. 40	9	15, 248. 93	81, 975. 00	500. 00	4. 3	4. 29	4. 34
1936	258, 505. 56	6	43, 084. 26	200, 460. 00	3, 500. 00	4. 8	3. 98	4. 01
1936–48	17, 766, 671. 42	188	94, 503. 57	4, 968, 620. 00	400. 00	--------	4. 71	6. 53

[1] Dividends adjusted for profit or loss on disposal of stocks.

Rate of interest earned on stock portfolio of Jefferson Standard Life Insurance Co., 1936–48

	Dividends received		Rate of dividend return on stocks		Total income from stocks [1]		Total rate of return on stocks	
	Common	Common and preferred	Common	Common and preferred	Common	Common and preferred	Common	Common and preferred
			Percent	*Percent*			*Percent*	*Percent*
1948	$733, 447. 20	$1, 082, 732. 87	6. 12	5. 54	$803. 891. 02	$1, 135, 337. 62	6. 70	5. 81
1947	616, 045. 45	919, 240. 27	5. 58	5. 36	617, 823. 25	934, 368. 63	5. 59	5. 45
1946	255, 371. 43	567, 821. 79	2. 50	3. 54	255, 371. 43	567. 821. 79	2. 50	3. 54
1945	215, 706. 50	519, 794. 82	2. 53	3. 59	2, 847, 539. 76	3, 246, 234. 57	33. 38	22. 39
1944	211, 832. 64	457, 561. 39	4. 96	5. 18	211, 344. 89	446, 066. 56	4. 95	5. 05
1943	194, 392. 63	445, 510. 60	6. 25	6. 14	194, 392. 63	467, 851. 97	6. 25	6. 45
1942	167, 217. 90	380, 660. 03	6. 49	5. 45	167, 217. 90	378, 219. 22	5. 49	5. 42
1941	168, 676. 89	327, 730. 62	6. 96	5. 79	6, 130. 10	484, 100. 07	. 25	8. 56
1940	207, 208. 90	346, 971. 69	5. 33	5. 21	167, 289. 82	320, 151. 76	4. 30	4. 81
1939	163, 366. 21	236, 736. 85	3. 59	3. 79	163, 938. 21	221, 418. 06	3. 60	3. 55
1938	128, 004. 50	202, 410. 60	3. 62	4. 35	126, 579. 35	207, 173. 98	3. 58	4. 55
1937	136, 253. 85	205, 147. 06	4. 29	4. 81	137, 758. 85	223, 234. 56	4. 34	4. 23
1936	129, 692. 85	201, 760. 85	3. 98	4. 57	130, 404. 69	203, 422. 69	4. 01	4. 60
	------------	------------	4. 71	4. 87	------------	------------	6. 53	6. 57

[1] Adjusted for profits or losses on disposal of securities.

Distribution of stock portfolio of Jefferson Standard Life Insurance Co., Dec., 31, 1948

	Common	Percent of stocks	Percent of admitted assets	Preferred	Percent of stocks	Percent of admitted assets	Amount of private placements	Percent of stocks
Railroad	$138, 662. 00	0. 71	0. 06	$144, 502. 00	0. 74	0. 06		
Public utility	862, 034. 50	4. 41	. 39	1, 181, 103. 42	6. 04	. 53	------------	------
Banks and insurance	7, 091, 217. 79	36. 28	3. 21	------------	------	------	------------	------
Industrial and miscellaneous	3, 897, 569. 98	19. 94	1. 76	6, 229, 283. 89	31. 87	2. 82	3, 576, 305	18. 29
Total	11, 989, 484. 27	61. 34	5. 42	7, 554, 889. 31	38. 66	3. 41	3, 576, 305	18. 29

Total common and preferred stock owned	$19, 544, 373. 58
Total admitted assets	221, 144, 910. 79
Total stocks as a percent of admitted assets	8. 83

Geographical location and type of business property owned and recorded in the investment real estate account of Jefferson Standard Life Insurance Co., Dec. 31, 1948

Location	Number of parcels	Office buildings	Laundries	Theaters	Other commercial	Total book value
California	1				$521,781.00	$521,781.00
Florida	5		$627,655.79			627,655.79
Georgia	2		33,175.00		171,584.00	204,759.00
Illinois	1	$1,172,777.66				1,172,777.66
Kentucky	1		154,602.31			154,602.31
Louisiana	2		121,173.98		195,381.83	316,555.81
Maryland	1	109,434.00				109,434.00
Massachusetts	1			$627,738.32		627,738.32
Missouri	1				77,171.45	77,171.45
New Jersey	5		180,200.00		630,155.19	810,355.19
New York	1				162,475.00	162,475.00
North Carolina	5		91,366.34	262,910.90	951,008.10	1,305,285.34
Ohio	2			474,805.00	229,946.25	704,751.25
South Carolina	2		57,585.75			57,585.75
Tennessee	3		483,740.31			483,740.31
Virginia	1		60,361.20			60,361.20
Total	34	1,282,211.66	1,809,860.68	1,365,454.22	2,939,502.82	7,397,029.38

Selected data on private placements of Jefferson Standard Life Insurance Co., 1936–48

Year	Total amount of securities purchased direct	Private placements as a percent of total stocks and bonds acquired [1]	Maximum amount	Minimum amount	Total number	Average size	Average maturity (years)	Average rate of interest (percent)
1948	$11,450,000.00	76.0	$4,000,000	$100,000.00	20	$572,500.00	12.1	4.75
1947	12,911,250.00	85.9	3,500,000	25,000.00	24	537,968.75	14.5	4.74
1946	10,905,325.00	71.7	3,500,000	75,000.00	15	727,021.67	12.9	4.90
1945	5,544,041.72	44.0	1,450,000	50,000.00	11	504,003.79	17.3	5.36
1944	3,755,000.00	60.9	2,000,000	97,500.00	7	536,428.57	15.4	5.07
1943	1,427,755.03	29.3	400,000	90,000.00	6	227,959.17	14.8	5.25
1942	3,659,700.00	72.5	650,000	58,500.00	11	332,700.00	17.9	4.77
1941	3,574,000.00	57.4	900,000	245,000.00	8	446,750.00	14.5	5.38
1940	1,300,000.00	45.3	350,000	50,000.00	7	185,714.28	13.6	5.34
1939	2,665,298.70	63.3	600,000	32,400.00	12	222,108.16	9.6	5.62
1938	957,756.45	57.3	350,000	53,256.45	6	159,626.00	13.6	5.91
1937	2,084,526.05	73.3	450,000	50,000.00	8	260,565.75	14.6	5.68
1936	579,500.00	23.4	300,000	62,500.00	3	193,166.67	12.0	6.00
1936–48	60,814,152.95		4,000,000	25,000.00	138	377,424.06	14.1	5.29

[1] Government bond purchases have been excluded from these figures.

Size of borrower at the nearest date after the closing of the loan of all direct placements of Jefferson Standard Life Insurance Co., Dec. 31, 1948

Assets of borrower	Number	Percent of total	Cumulative percent of total
Under $550,000	19	24.0	24.0
$550,000 to $1,000,000	14	17.8	41.8
$1,000,000 to $1,500,000	8	10.1	51.9
$1,500,000 to $2,000,000	9	11.4	63.3
$2,000,000 to $3,000,000	8	10.1	73.4
$3,000,000 to $4,000,000	8	10.1	83.5
$4,000,000 to $8,000,000	6	7.8	91.3
$8,000,000 to $12,000,000	5	6.3	97.6
$12,000,000 to $21,000,000	2	2.3	99.9

Total mortgages held by Jefferson Standard Life Insurance Co., Dec. 31, 1948

Size of mortgage	Cumulative percent of total	Percent of total number	Number	Total original amount	Percent of total amount	Cumulative percent of total
Under $5,000	42.1	42.1	4,195	$14,141,047.19	10.5	10.5
$5,000 to $15,000	84.2	42.1	4,199	31,293,442.48	23.2	33.7
$15,000 to $35,000	94.6	10.4	1,041	21,706,688.19	16.1	49.8
$35,000 to $100,000	98.3	3.7	364	18,864,303.81	13.9	63.7
$100,000 to $500,000	99.7	1.4	144	26,993,090.74	20.0	83.7
$500,000 to $1,000,000	99.9	.2	12	8,298,000.00	6.2	89.9
$1,000,000 and over	100.0	.1	8	13,617,285.60	10.1	100.0
Total		100.0	9,963	134,913,858.01	100.0	

Total single-family residential mortgages held by Jefferson Standard Life Insurance Co., Dec. 31, 1948

Size of mortgage	Cumulative percent of total	Percent of total number	Number	Total original amount	Percent of total amount	Cumulative percent of total
Under $5,000	55.3	55.3	3,619	$12,216,483.87	35.4	35.4
$5,000 to $15,000	97.7	42.4	2,772	19,160,279.36	55.5	90.9
$15,000 to $35,000	99.8	2.1	142	2,561,744.85	7.4	98.3
$35,000 to $100, 00	100.0	.2	11	572,620.00	1.7	100.0
Total		100.0	6,544	34,511,128.08	100.0	

Total multifamily residential real estate mortgages held by Jefferson Standard Life Insurance Co.; Dec. 31, 1948

Size of mortgage	Cumulative percent of total	Percent of total number	Number	Total original amount	Percent of total amount	Cumulative percent of total
Under $5,000	15.5	15.5	100	$374,590.31	3.6	3.6
$5,000 to $15,000	66.0	50.5	325	2,872,105.00	27.5	31.1
$15,000 to $35,000	91.5	25.5	164	3,540,773.56	33.9	65.0
$35,000 to $100,000	98.4	6.9	45	2,191,000.00	20.9	85.9
$100,000 to $500,000	100.0	1.6	10	1,477,492.74	14.1	100.0
Total		100.0	644	10,455,961.61	100.0	

Total farm mortgages held by Jefferson Standard Life Insurance Co., Dec. 31, 1948

Size of mortgage	Cumulative percent of total	Percent of total number	Number	Total original amount	Percent of total amount	Cumulative percent of total
Under $5,000	41.4	41.4	164	$485,027.79	4.9	4.9
$5,000 to $15,000	78.5	37.1	147	1,156,360.99	11.5	16.4
$15,000 to $35,000	89.9	11.4	45	965,680.40	9.6	26.0
$35,000 to $100,000	97.5	7.6	30	1,715,357.96	17.1	43.1
$100,000 to $500,000	99.5	2.0	8	1,205,000.00	11.9	55.0
$500,000 to $1,000,000	99.5	0.0	0	0	0.0	55.0
$1,000,000 and over	100.0	.5	2	4,517,285.60	45.0	100.0
Total		100.0	396	10,044,712.74	100.0	

Total hospital, church, and lodge mortgages held by Jefferson Standard Life Insurance Co., Dec. 31, 1948

Size of mortgage	Cumulative percent of total	Percent of total number	Number	Total original amount	Percent of total amount	Cumulative percent of total
Under $5,000	8.9	8.9	14	$55,100.00	1.1	1.1
$5,000 to $15,000	46.4	37.5	59	516,572.00	9.9	11.0
$15,000 to $35,000	80.3	33.9	53	1,075,158.42	20.5	31.5
$35,000 to $100,000	93.0	12.7	20	1,078,000.00	20.5	52.0
$100,000 to $500,000	99.4	6.4	10	1,765,000.00	33.7	85.7
$500,000 to $1,000,000	100.0	.6	1	750,000.00	14.3	100.0
Total	----------	100.0	157	5,239,830.52	100.0	----------

The CHAIRMAN. Is this a stock company?

Mr. BRYAN. Yes, sir.

The CHAIRMAN. Have you paid dividends to your stockholders?

Mr. BRYAN. Yes, sir.

The CHAIRMAN. Over what period?

Mr. BRYAN. I would say without interruption since our organization in 1907. I think I have a record of it here. It goes back over quite a period of years.

The CHAIRMAN. How many stockholders?

Mr. BRYAN. Something around 2,000.

The CHAIRMAN. Where do they reside?

Mr. BRYAN. They reside pretty much all over the country, but mostly on the Eastern Seaboard and primarily in the Southeast.

The CHAIRMAN. Is it a subsidiary of any other corporation of any kind?

Mr. BRYAN. No.

The CHAIRMAN. Wholly independent?

Mr. BRYAN. Yes, sir.

The CHAIRMAN. I observe from your statement that a very large percentage of your investments are in small loans. It is an unusually large percentage, is it not?

Mr. BRYAN. I am not able to say. I do not have the statistics on the other companies. I believe I only have what was given here yesterday, but I think we perhaps are like a great many of the smaller companies, we have smaller loans.

The CHAIRMAN. I wanted to ask you the same question I asked of Mr. Clark just before he left the stand, whether from your experience the State companies, the small insurance companies, handle or fill in that gap which is apparently not handled by the large national companies, in loans to small business and to small borrowers.

Mr. BRYAN. I did not hear Mr. Clarke's answer.

The CHAIRMAN. I want your answer and not his.

Mr. BRYAN. I will give it to you as best I can. I think we do supply a need to the local borrower, to the small borrower, in our respective communities that perhaps the larger companies cannot.

The CHAIRMAN. Do you compete with the larger companies for business?

Mr. BRYAN. I am afraid they compete with us now, Senator.

The CHAIRMAN. In what field? They do not compete for these real-estate mortgages of less than $15,000?

Mr. BRYAN. I am not so sure. As a matter of fact, as far as residential loans are concerned, I would say they are competing in that field very actively, too strong for us.

The CHAIRMAN. Does that result in giving the householder a lower rate of interest?

Mr. BRYAN. Well, I am afraid it does.

The CHAIRMAN. I observed with a great deal of interest your statement on page 4 about the investment of 4 percent of your assets in sale and lease-back of real estate and your statement that the North Carolina law permits that sort of investment.

Was that a recent change of North Carolina law, or has that been the case from the beginning?

Mr. BRYAN. No; it was a law that was passed in 1943. We were one of the early States that had it. I think Virginia was the first State and possibly then North Carolina the second permitting this type of investment.

The CHAIRMAN. How does that operate? Who are the borrowers, so to speak, with whom such investments are made? You purchase the real estate and lease it back to them?

Mr. BRYAN. Yes; over a long period of years.

The CHAIRMAN. What is that type of business? Who sells it to you?

Mr. BRYAN. Well, the owner may be a national concern, a local concern, an industrial concern, or it may be a real-estate property. They are interested in putting more capital in their business and prefer, I would imagine, to have that money working as working capital, so that the real estate is sold to us and we in turn lease it back to them over a period of years with an annual rental of some mutually agreed upon amount.

The CHAIRMAN. By and large, what is the return which you receive from such an investment with relation to the actual purchase price that you pay?

Mr. BRYAN. The purchase price determines the rental as a rule at a fixed rate of return and for a rough calculation—and I can say it is only rough—I would say around 6 percent as a fixed annual charge of the original principal amount.

The CHAIRMAN. In other words, the real-estate owner, the industrial corporation, or the retail corporation, which wants to follow this practice, sells to the insurance company but only upon a definite understanding that the rental which will be paid during this term of years shall not give you more than 6 percent upon the investment in the real estate; is that correct?

Mr. BRYAN. That is correct.

The CHAIRMAN. So that the initiative comes from them rather than from you. They bargain for the rental, do they not?

Mr. BRYAN. I would say in most cases I have observed they have; yes. We are approached either by a broker, investment house, or by themselves.

The CHAIRMAN. In other words, you are given the opportunity to buy this and get a rental which will pay you 6 percent. They write the ticket and you take it or leave it. Is that not the way it goes?

Mr. BRYAN. That ticket is subject to some examination on our part.

The CHAIRMAN. Well, I have no doubt, but I mean by and large, is that not what it amounts to? It has been said, for example, that one of the objectives of that sort of sale and lease-back arrangement is to avoid taxation, because the rental then goes into the expense of operation; and with a large operating company, that is a very important factor.

Mr. BRYAN. You want me to comment on that?

The CHAIRMAN. Yes.

Mr. BRYAN. The fact that it is tax-exempt or may have tax advantages I think is apparent. In our particular case we have not been told why they felt they wanted to do this. I have known of instances, as I have related, where I felt it was in order that they could retain working capital in their business or get more working capital. It is a method of raising additional money.

The CHAIRMAN. As long as they have a guaranty for a certain number of years that they will be the renter, they have the site, and the return which they receive from the sale of the real property can then be devoted to the other aspects of the business.

Mr. BRYAN. That is right.

The CHAIRMAN. This law was enacted in 1942?

Mr. BRYAN. In our State in 1943.

The CHAIRMAN. In your State, and prior to that time in Virginia?

Mr. BRYAN. Yes, sir; in 1942 by Virginia.

The CHAIRMAN. And your opinion is that that was the beginning of the movement?

Mr. BRYAN. As far as I know; yes. That is the best of my recollection.

The CHAIRMAN. Was it necessary to change laws in other States, do you know?

Mr. BRYAN. Yes.

The CHAIRMAN. How about the State of New York?

Mr. BRYAN. New York changed its law, I think, some 2 or 3 years ago.

The CHAIRMAN. So that this type of investment for insurance companies has become much more prevalent in recent years?

Mr. BRYAN. That is right. In the last 2 years there has been a considerable investment in that type. We have not made as much as we had formerly, however. The rates on that, again on account of competition, started to go down, and we felt the field has been fairly thoroughly explored at the rates offered today by other companies.

The CHAIRMAN. I wonder, Mr. Woodward, if you and Dr. O'Leary would put your research staff to work upon this matter, if you have not already done so, and give the committee your best statistics on the amount of insurance funds involved in sale and lease-back proposals or operations.

Mr. WOODWARD (Donald B. Woodward, second vice president, Mutual Life Insurance Co. of New York). We will be glad to do that and provide them for the record.

Mr. BRYAN. I think those figures are available so far as the industry is concerned.

The CHAIRMAN. I have no doubt they are.

Mr. BRYAN. Incidentally, you might be interested to know that in North Carolina we have a limitation that only 4 percent of our assets can be put in this type of property or investment and that in no case shall we have more than 10 percent in all real estate holdings.

The CHAIRMAN. I think it would be well also, Mr. Woodward, if in that study you should find out what the limitations are in the various States. Mr. Bryan calls our attention to the fact that only 4 percent of the assets of an insurance company in North Carolina may be invested in this type of loan, and what was the other limitation?

Mr. BRYAN. Ten percent in total amount of real estate.

(The information referred to above is as follows:)

Purchase and lease-back operations for the 17 companies on which detailed information was presented on bonds and mortgages is as follows:

Three of the 17 companies report no such investments. The remaining 14 had such investments at December 31, 1948, of $155,583,450.69 and acquisitions for these companies during 1948 were reported to be $61,783,749.37.

The following tabulation made by the Life Insurance Association of America provides a statement showing the statutory provisions regarding real-estate investments:

Summary of legislation as to income-producing real estate investments by life insurance companies

State	Year	Aggregate limit percent of assets	Parcel limit, percent of assets	Annual write-down percent	Type
Arizona	1948	10	5	None	General [1]; domestic and foreign companies.
Arkansas	1947	None	None	None	General.
California	[2] 1945	5	1	None	General: "admitted" companies.
Colorado	1947	10	1	1½	General.
Connecticut	[2] 1945	5	None	None	Otherwise unauthorized.[3]
Delaware	1947	5	None	None	Do.
	1947	None	None	None	General; foreign companies.
District of Columbia	1948	[4] 5	None	None	General.
Georgia	1947	[5] 5	None	([6])	Leasing.[7]
Idaho	1949	5	None	None	General.
Illinois	1947	5	None	None	Otherwise unauthorized.
Indiana	[2] 1945	5	None	([6])	Leasing.
Iowa	1947	[8] 5	None	None	General.
Kansas	1947	[9] 10	([10])	2	Do.
Louisiana	1948	5	None	None	Otherwise unauthorized.
Maryland	[11] 1947	[12] 5	1	2	General.
Massachusetts	1947	[12] 3	1	2	Do.
Minnesota	1947	3	¼	2	Do.
Mississippi	1946	15	None	None	Do.
Missouri	1948	5	None	None	Do.
Nebraska	1947	5	1	2	Do.
	1945	None	None	([6])	Leasing.[7]
Nevada	1949	15	None	None	General.
New Hampshire	1949	5	None	None	Otherwise unauthorized.
New Jersey	[13] 1945	5	None	([14])	General.
New Mexico	1947	10	None	None	Do.
New York	[2] 1946	3	¼–½	2	Do.
North Carolina	1945	([15])	None	([6])	Leasing.
North Dakota	1949	10	1	2	General.
Ohio	1947	5	None	None	Otherwise unauthorized.
Oregon	1947	([16])	None	None	Do.
Pennsylvania	1947	10	None	2	General.
Rhode Island	1947	[9] 20	None	None	General: domestic and foreign companies.
Tennessee	1947	[17] 10	2	None	General.
Utah	1947	[17] 20	None	None	Do.
Vermont	[11] 1947	5	None	([6])	Leasing.[7]
Virginia	1942	[18] 5	None	([6])	Do.
Washington	1947	([19]) (a)	([20])	None	Otherwise unauthorized.
West Virginia	1949	([21])	None	([6])	Leasing.
Wisconsin	[2] 1945	5	None	None	Otherwise unauthorized.
Wyoming	1947	None	None	None	General; domestic and foreign companies.

No attempt has been made to digest restrictions other than those pertaining to percentage of assets limitations and annual write-down. Statutes expressly refer to domestic companies unless otherwise noted.

[1] Contains general authorization of investment in real estate for the production of income.
[2] Amortized 1947.
[3] Permits investments not otherwise qualifying or permitted under charter or domiciliary law.
[4] Two percent during 12 months; 10 percent on all real estate.
[5] Twenty-five percent on all real estate. [6] Amortization.
[7] Authorizes investment in real estate for leasing purposes under prescribed conditions as to length of term, type of lessee, improvements, taxes, insurance, allowance as assets, etc.
[8] Reserves. [9] For all real estate. [10] Lesser 2 percent assets or 50 percent surplus.
[11] Amortized 1949. [12] For all real estate. [13] Amortized 1946. [14] Amortized leasehold.
[15] Lesser of 4 percent assets or 50 percent capital and surplus.
[16] Lesser of 7½ percent assets or surplus over liabilities. [17] On all real estate.
[18] 15 percent as to all real estate.
[19] (a) Lesser of 5 percent assets or 50 percent surplus over capital, etc.
[20] Lesser of 1 percent assets or (a).
[21] Lesser of 5 percent assets or capital and surplus.

The CHAIRMAN. Any questions, Mr. Scoll?

Mr. SCOLL. Will you turn to the tables, Mr. Bryan? You have a table entitled "Total Commercial Business and Industrial Mortgage Loans Held by Jefferson Standard Life Insurance Co., December 31, 1948." That is supplemental question D, part 2.

Mr. BRYAN. Yes, sir.

Mr. SCOLL. That table shows that as of December 31, 1948, you had a total number of 298 loans under $5,000. Now, were those mortgage loans to commercial and business firms, or were they on residence properties?

Mr. BRYAN. These are commercial business and industrial loans only. They were so classified.

Mr. SCOLL. Similarly, at your next classification, five to fifteen thousand, you had 896 loans totaling $7,588,000-odd, accounting for 40 percent of your total number of loans.

So that of your commercial business loans 53 percent were under $15,000; is that right?

Mr. BRYAN. By number, yes; by number of loans.

Mr. SCOLL. Now, can you tell us what generally was the purpose of these various loans?

Mr. BRYAN. I could not describe them other than that they are, as I say, small commercial and business loans.

Mr. SCOLL. Do you know whether they were for paying debts or for expanding operations or anything of that sort?

Mr. BRYAN. We have the figures on private placements, but we do not have the figures on this. I might be able to obtain it for you, but it would take considerable research.

Mr. SCOLL. Let's pursue the point further and it might not be necessary to do any research.

These small loans, where were they made mostly? Are they scattered around the country?

Mr. BRYAN. They are scattered over the country. I would say mostly in the territories in which we operate as an insurance company and primarily in the Southeast. We have a geographical classification, I think, of those loans.

Mr. SCOLL. Yes, I see your table of classification. It is here. I was just curious to know where most of these small loans were.

Mr. BRYAN. It would only be a generalization. I would say they are mostly in the Southeast, plus Texas and—begging Mr. Clarke's pardon—California.

Mr. HERTER. Florida is included, too; is it not?

Mr. BRYAN. Yes, sir.

Mr. SCOLL. There was one point I wanted to get absolutely clear in the record. What we are talking about now are mortgage loans to businesses.

Mr. BRYAN. Yes, sir.

Mr. SCOLL. Not residence loans?

Mr. BRYAN. That is right.

Mr. SCOLL. Now, turning to your supplemental D, part 2, for private placements, I notice this covers the period 1936 to 1948. There you have a total number of 30, accounting for 21.7 percent of the total number of loans under a hundred thousand, accounting for a little over 3 percent of the loans made.

Now, then, your next classification, 100 to 200, you have 24 loans accounting for 17 percent of the total number of loans; so that under 200,000 you had roughly 40 percent of your loans in number and about 9½ percent in amount.

Can you tell us generally what was the purpose of the borrower and the use of the money? Do you have in a general way that answer? Can you characterize what the money was used for?

What I am trying to get at is to find out if much of this money is used for expansion or do they borrow money from you for paying other debts?

Mr. BRYAN. This is for the total amount here.

Mr. SCOLL. You mean of your 60 million?

Mr. BRYAN. If you will turn to supplemental question D, part 4, on number 7——

Mr. SCOLL. Yes, I see you have it here. That is for the total.

Mr. BRYAN. That is the total. I do not have it broken down under two hundred.

Mr. SCOLL. So that this shows that of all your private placements, approximately 52 percent was for expansion and that is just expansion alone, and the rest was mixed for working capital and expansion.

Mr. BRYAN. That was of the loans on our books at the end of 1948 as contrasted with the total number placed during the period originally referred to.

The CHAIRMAN. In making a loan for working capital, Mr. Bryan, what requirements do you ask the borrower to meet?

Mr. BRYAN. In making a loan for working capital?

The CHAIRMAN. Yes. Apparently there were 12 of these, totaling $2,860,000. Now, I ask the question because I have found from communications and statements made to me that it is precisely in that field that small business finds its greatest difficulty in getting working capital for any long-term period. Short-term loans are readily accessible at the banks, but the uncertainty with respect to renewal is an impediment to small business. A long-term loan for working capital is of great assistance to small business.

Mr. BRYAN. I do not think our requirements in that connection are any different than in the case of a new plant. We try to appraise all factors, physical property, possible earning power, past earning power, management, and so forth. There would be no hard and fast rule that I would say would apply to working capital.

The CHAIRMAN. This table, which shows that out of $28,093,000, you have placed six and one-half million in new expansion, two million eight in working capital, and six million six in purchase and expansion, and then one million one in expansion and working capital, and it would seem to indicate that a very substantial part of the total has gone for expansion of business.

Mr. BRYAN. That is right.

The CHAIRMAN. Of course, it is obvious from the very first statement that you made this morning that an expanded economy is needed if life companies are going to invest roughly $50,000,000 per working day.

Mr. BRYAN. Right.

The CHAIRMAN. It means that both Government and business have to cooperate to produce the conditions that will permit an expanding economy to proceed, and I may say to you that from my own point of view, that is what lends greatest importance to the operation of the small, local, life-insurance company, the small local, regional, or State loaning agency. Anything we can do, always considering the soundness of the operation, the soundness of the loan, to stimulate the flow of capital into such enterprises, it seems to me is good for the entire economy, including the big fellows at the top.

Do you agree?

Mr. BRYAN. I would not have any argument with you there; no, sir.

Mr. SCOLL. Your private placement category of loan, I take it, includes all the unsecured loans to business; is that right?

Mr. BRYAN. Yes, debenture issues, you mean?

Mr. SCOLL. Yes.

Br. BRYAN. Yes.

Mr. SCOLL. Going back to these mortgage loans that you make to business and commercial enterprises, what factors do you take into consideration in determining whether or not to make a mortgage loan to a small business? Would you care to evaluate that?

Mr. BRYAN. It is primarily based on appraisal of property offered as security.

Mr. SCOLL. Primarily on the property offered for security?

Mr. BRYAN. Yes, sir.

Mr. SCOLL. So that you look to the security primarily and not to the man's over-all business record and earnings?

Mr. BRYAN. It is a factor.

Mr. SCOLL. It is a factor?

Mr. BRYAN. Yes.

Mr. SCOLL. But you do look to the security primarily?

Mr. BRYAN. Yes.

Mr. SCOLL. Now, yesterday it was suggested, or 2 days ago it was suggested to the committee that the Government or Congress should create a business loan scheme in which the United States Government would insure the business loans somewhat in the manner that title I of FHA loans are insured by the Government for the lending agency.

If such a plan were in effect, would you make more such small loans as you have made, do you believe, or would it make any difference to your operation?

Mr. BRYAN. I do not think in our particular case it would; no. I think as far as volume is concerned, in our own territory we are serving all the needs, at least those that come to our attention. I would not personally mind participating or exploring the possibility of the suggestion you have made. It might possibly be the answer, I do not know. I would be hopeful that we in the life insurance business could do this job ourselves.

Mr. SCOLL. How long have you been making mortgage loans to small business?

Mr. BRYAN. That goes back long before my time, and I have been there 20 years.

Mr. SCOLL. Does the fact that you are a stock company and not a mutual company have any bearing on your policy, your over-all investment policy, concerning common stocks?

Mr. BRYAN. I cannot see that it does. Personally, as a stockholder I might work harder. I am not sure.

Mr. SCOLL. A question has been raised as to whether or not mutual companies could invest in common stocks, and it was pointed out to me that there is a difference. Stock companies can do so and mutual companies cannot. I do not know whether you can elucidate to the committee on that.

Mr. BRYAN. As far as I know——

Mr. SCOLL. Apart from State regulations.

Mr. BRYAN. Where the insurance departments permit, whether they are mutual or stock, it does not make any difference. I have my own theory about the stock-investment possibilities for life-insurance companies. I do not think necessarily it might answer the problem that is being presented here.

I have held to a theory for a long while that there is a place in the portfolio of, I think, all life-insurance companies for common stocks on the basis of diversification, on the basis that it is a good investment. If you can have those two factors present, I cannot see what is wrong with it. The valuation difficulty has been brought up. I think it is a good one and one that presents a problem. I do not think it is insurmountable. I think it could be handled.

For our part, we have, as you see, $19,000,000 in common stocks, and those stocks have been bought over a long period of years, both common and preferred. The stocks represent on the market, I would say, some $3,000,000 roughly appreciation over book. We carry them, however, at book. We carry them at cost or market, whichever is lower. That affords us a leeway, a cushion, and I think, in a sense, takes care of some of that valuation problem.

You will then say: What about the company that does not have a cushion already established? I still think that could be possibly handled by any return over and above say the required interest assumption for policy reserves being established as a fluctuation reserve and being set aside for that purpose.

The CHAIRMAN. Mr. Bryan, I notice from your statement here, supplemental question D, part 3, that you have a gross stock investment in textiles amounting to $3,678,270.16. Could you give us any idea when the price of shirts will go down?

Mr. BRYAN. If you had bought them last spring, Senator, you could have bought them cheaper.

The CHAIRMAN. Is inflation in shirts coming on?

Mr. BRYAN. Yes. Last spring they were cheap. Right now the textile industry seems to be suffering from a shortage of material. They are working night and day.

The CHAIRMAN. I observe here, seriously speaking, that textiles account for the largest proportion of your common stock investment.

Mr. BRYAN. That seems to be correct; yes, sir.

The CHAIRMAN. What is your return?

Mr. BRYAN. We do not have that broken down on textiles. It is a generous one. I would say it would run—our average return on common stocks is a little over 5 percent.

The CHAIRMAN. Does that include purchase and sale as well as dividend return?

Mr. BRYAN. Excuse me. I have the figures in front of me now. I am underestimating. For 1948 it was 6.12. For 1947 it was 5.58. That does not include appreciation or depreciation in sales or purchases. They have been of a negligible character.

The figure for that, after profit and loss, disposal of stocks, was in 1947, 5.59, not much different from the other, and in 1948 it was 6.70.

The CHAIRMAN. Now, are these local stocks or national stocks?

Mr. BRYAN. They are primarily local stocks. We do have some national stocks.

The CHAIRMAN. So that, by and large, the stock investments of Jefferson Standard are in commercial and industrial enterprises of the area that you serve?

Mr. BRYAN. Yes, sir.

Mr. HERTER. The Senator did not ask you how many of those have come down from New England to North Carolina.

Mr. BRYAN. That is a touchy subject in New England.

Mr. HERTER. In connection with that same table, I was fascinated to see that among your industrial bonds almost 50 percent are in newspapers and that you have quite a large stock ownership in newspapers and a very large stock ownership in radio stations, which is a rather unusual item to find in this type of investment.

Are those mostly local again?

Mr. BRYAN. The newspaper constitutes, as you see, an original amount of approximately 18½ million dollars, the principal amount unpaid presently is 13½ million dollars. They are pretty well spread over the territory in which we operate. That is as far as newspapers are concerned.

The radio, that is a wholly owned subsidiary.

Mr. HERTER. Wholly owned subsidiary of the company itself?

Mr. BRYAN. Primarily. We have a minor investment in another company in which we own two-thirds. This 1,287,000, for the purpose of your consideration, that is a wholly owned subsidiary. We own all the stock.

Mr. HERTER. I was particularly interested in that, not because it is directly pertinent to this hearing, but I recall some time ago, I think there was a good deal of discussion of Aetna's holding of a radio station in Hartford, Conn.

Mr. BRYAN. I think it was another company.

Mr. HERTER. Travelers, I guess it was. There was a good deal of complaint because of the relative tax picture, that it was an unfair device to have it wholly owned by the insurance company.

Mr. BRYAN. Ours is a stock ownership. We do pay taxes, the subsidiary pays taxes.

The CHAIRMAN. Do you have any other subsidiaries?

Mr. BRYAN. Yes, we have another radio station and we also own a life-insurance company, called the Pilot Life Insurance Co.

The CHAIRMAN. Now, you have a newspaper that is wholly owned?

Mr. BRYAN. No, sir, we do not own the newspaper.

The CHAIRMAN. Radio stations?

Mr. BRYAN. Yes, sir.

The CHAIRMAN. Two radio stations that are wholly owned. Is there any other industry?

Mr. BRYAN. We have this subsidiary life insurance company.

The CHAIRMAN. I was classifying that as insurance and fiscal and not industrial.

Mr. BRYAN. I would say perhaps we have a large ownership in banks.

The CHAIRMAN. But not in industrials?

Mr. BRYAN. I beg your pardon?

The CHAIRMAN. Not in any other industrials?

Mr. BRYAN. We do not own any industrial—no, we own some stock, but we do not have any ownership as such that we might call it a subsidiary.

Mr. HERTER. No hotels, motels, or anything of that kind? You have a large investment in those but none of those are wholly owned by you?

Mr. BRYAN. No, and I hope they will not be.

The CHAIRMAN. Do you exercise any managerial influence upon the companies in which you own stock outside of those which are wholly owned?

Mr. BRYAN. None at all. We are represented on the board of a bank that we own stock in. I say represented. I am on the board. Whether that is good representation or not——

The CHAIRMAN. I would accept it. How about the textile companies?

Mr. BRYAN. No.

The CHAIRMAN. You do not attempt to——

Mr. BRYAN. None at all.

The CHAIRMAN. Do you think, then, that it would be possible to continue this policy throughout the United States with respect to insurance companies of investing in common stocks which actually represent the ownership of such companies without having the insurance companies eventually get into the management?

Mr. BRYAN. If they own the companies, they would have to manage them. If they own minor amounts of the stock, I do not think it is necessary and I do not think it is advisable. As stated here by Mr. Clarke, the management of a life insurance company is enough without trying—as a matter of fact, investment, as I see it, in common stocks is investment in management.

The CHAIRMAN. Now, how do you explain this venture into the radio business?

Mr. BRYAN. How did it come about?

The CHAIRMAN. Was that done as an investment policy in the first place?

Mr. BRYAN. It was done from an investment and from a local interest standpoint. We were pressed by the owners, Columbia Broadcasting System, who wanted to sell the station. We had owned a small station in our town for a number of years, which had started from nothing, and we had become well acquainted with it, and they suggested possibly we would be interested in buying this large station. At that time the purchase of it was being entertained by outside interests, and we had some interest in its being kept in North Carolina, and we bought it. It is a good investment. It does present some management problems, and that is why I speak so feelingly, perhaps, on trying to divest myself of any interest in managing other properties.

The CHAIRMAN. As a matter of general policy, do you think life insurance funds should be invested in wholly-owned industrial or commercial subsidiaries?

Mr. BRYAN. You mean——

The CHAIRMAN. As a general policy.

Mr. BRYAN. You mean as to ownership as a subsidiary?

The CHAIRMAN. That is right.

Mr. BRYAN. No, I would not approve of that.

The CHAIRMAN. Is that not what this is?

Mr. BRYAN. This one?

The CHAIRMAN. Yes.

Mr. BRYAN. Yes, sir, except that it might be classified as an operation that is complementary to our business. It is not beyond the realm of possibility that it is something in the public interest we could do at that particular time better than somebody else. We thought so.

The CHAIRMAN. Your answer would seem to indicate there was a large degree of local public interest involved in this, and I am trying to separate that from the general principle.

In other words, should insurance companies as a policy invest the policyholders reserves in industrial enterprises which are wholly owned and which, therefore, must be managed my the insurance company through some method?

Mr. BRYAN. I would say "No."

The CHAIRMAN. Are there any other questions?

Mr. SCOLL. No.

Mr. HERTER. No.

The CHAIRMAN. Mr. Bryan, we are very much obliged to you, sir, for your appearance here and your ready response to all the questions, and particularly also for the fairness of this statistical information which has been given to us in response to the questionnaire.

Mr. Devereaux C. Josephs, president of the New York Life Insurance Co., will be our witness this afternoon. It is now 12:45, so the committee will assemble at 2:30.

(Whereupon, at 12:45 p. m., the subcommittee adjourned, to reconvene at 2:30 p. m., of the same day.

AFTERNOON SESSION

(Present: Senator O'Mahoney, and Representative Herter and Buchanan.

(Also present: Theodore J. Kreps, director of staff.)

The CHAIRMAN. The committee will be in order.

I observe that the witness is all ready to proceed. Mr. Josephs.

STATEMENT OF DEVEREUX C. JOSEPHS, PRESIDENT, NEW YORK LIFE INSURANCE CO.; ACCOMPANIED BY R. K. PAYNTER, JR., FINANCIAL VICE PRESIDENT

Mr. JOSEPHS. Yes, sir; and this is Mr. Paynter, financial vice president of New York Life.

I have a memorandum here. May I read it?

The CHAIRMAN. If you will, please.

Mr. JOSEPHS. This is a memorandum on the policies and practices of the New York Life Insurance Co. affecting the volume and stability of private investments.

I appreciate very much the invitation which brings me before this committee. The savings of tens of millions of people are invested through life insurance companies. The purpose of life insurance funds is to protect the holders of policies and their dependents. Until needed for the purposes for which the policies were purchased, these funds are a source of capital essential to the operation of our national economy. No source has been discovered which can take the place of this one which has developed so naturally, nor is there a better example of the cooperative aspect of the free-enterprise system working at its best.

New York Life Insurance Co.: The New York Life Insurance Co. is a mutual company founded in 1845. With assets of $4,600,000,000 the company ranks fourth, having 8 percent of the assets of all life insurance companies. New York Life is the largest company which does only that type of business referred to as "ordinary insurance." It has not entered the fields of industrial and group insurance.

The company's policyholders and investments are located in all the 48 States, the District of Columbia, Alaska, Hawaii, and Canada. It has about 5,000 agents operating from 138 branch offices. There are outstanding approximately 4,000,000 policies which average $2,500 per policy.

The CHAIRMAN. What is the largest policy and what is the smallest?

Mr. JOSEPHS. The smallest is $1,000, and the largest—a single policy issued at one time, the limit is now $400,000; although we will, I think, cover $500,000 on the life, provided all aspects are exactly what we want—the question of age, et cetera.

The CHAIRMAN. Do you know at the moment how many $1,000 policies you carry?

Mr. JOSEPHS. No, sir; I do not.

The CHAIRMAN. Would you care to approximate it and then change it for the record and make it accurate?

Mr. JOSEPHS. It would be in the hundreds of thousands. The average of $2,500 per policy would indicate that it would be certainly in the hundreds of thousands. It might be in the millions.

At the lower end there has been a gradual increase in the size of policies issued over the last couple of decades.

The CHAIRMAN. And those premiums are paid in what installments?

Mr. JOSEPHS. They can be paid quarterly, semiannually, or annually. There are occasionally monthly policies, particularly on payroll deductions. And, of course, during the war we took over the opportunity to accord that provision of service.

The CHAIRMAN. Proceed.

Mr. JOSEPHS. New York Life Insurance Co. investment policy: In investing its policyholders' money the company seeks the best combination of security and return. Because the ultimate security of all of its investments depends upon the outcome of the larger economic society and because its policyholders and their dependents are members of that society, the company recognizes that its investments should be such as to serve the welfare of the economy as a whole.

The CHAIRMAN. I think that is a very excellent statement, Mr. Josephs. What this committee primarily is concerned about is the welfare of the larger economic society, knowing that unless the welfare of that society is preserved, it is scarcely possible for any segment to prosper.

Mr. JOSEPHS. That statement is most seriously made.

With economic developments the field of investment changes from time to time. Accordingly, the company adjusts its program, where possible, to meet the most insistent needs. There was a time when farm mortgages were a chief form of investment. Prior to World

War I, the greatest demand was from the railroads. Next, the heavy demand was for mortgage loans, the financing of the growing public utility services and the extensive borrowings by States and municipalities for public improvements.

During World War II the needs of our Government had the first call on our funds for investment. Since that time the principal demands which we have met have been for the financing of housing requirements all over the country, the expansion of the telephone companies, the utility services, and a great increase of the productive capacity of America.

The percentage distribution of the assets of this company on September 30, 1949, is shown below. These assets are largely in fixed income securities. The State of New York, under whose laws we operate, does not permit the purchase of common stocks.

	Percent
Bonds:	
U. S. Government	36.4
Other	40.8
Mortgage loans	11.2
Preferred stocks	2.7
Real estate	2.6
Cash, policy loans, et cetera	6.3
Total	100.0

On September 30, 1949, the company had 45,248 home mortgages outstanding for an average amount of $5,781; 1,721 apartment house mortgage loans for an average amount of $86,353; and 1,278 mortgage loans on commercial properties for an average amount of $82,222. During the past 12 months we have made single corporate investments ranging from $125,000 to $50,000,000.

Different demands for funds present themselves from time to time. We judge each demand on its own merits. After all, a life insurance company cannot create a demand for its funds but must choose those investments which are offered by the economy. In no case has the size of the loan or the source of the demand been the determining factor in our making any particular loan. The keystone of our investment policy has been our judgment of the protection and return afforded our policyholders' savings.

Volume: Turning now to volume, life insurance companies are the recipients for investment of the savings of many millions of policyholders. Broadly speaking, the volume of savings is determined by the habits of individuals. The life insurance companies are the pipe lines through which much of this volume is carried.

The future financial condition of life insurance companies can be forecast with greater accuracy than is possible in most industries, and so the volume of funds which they are likely to have for investment for the immediate future can be calculated. Currently life insurance assets have been growing at the rate of 7½ percent a year. During 1948 this growth was close to $4,000,000,000. Almost all of this financial growth is attributable to continued payments upon policies in force over a considerable period of time; nor does it depend immediately upon current sales activity. Because there is much factual evidence regarding the persistency of these periodic payments on well-established policies the volume of new money to be invested is relatively stable. Over a future period of, say, 5 years, the volume of new money to be invested by all the companies should be about 4½ billion dollars a year. This growth can be compared with the aggregate national investment of new private capital, including funds for housing, which was estimated for 1948 to be 10 times this figure.

Life insurance is so well established among the American people that annual variation from this established method of saving would occur slowly and thus indicate well in advance any change in the volume of funds for investment. Some factors, of course, might modify a forecast. Although, as stated above, the sale of new life insurance would not affect our financial growth immediately, the volume of life insurance savings could be reduced, as has happened in the past as a deflation advances, by reason of policyholders' surrender of contracts for cash and an increase in the volume of policy loans. The pattern of the past indicates that such change appears slowly, as illustrated by the record of growth of life insurance assets from the end of 1929 to 1939, from which has been subtracted the total of policy loans which naturally reduces the amount of new investment funds. This growth, expressed in percentages is shown below:

	Percent		*Percent*
1930	6	1935	8
1931	5	1936	9
1932	1	1937	6
1933	1	1938	7
1934	6	1939	7

The CHAIRMAN. I would say that the years from 1934 to 1939 were rather favorable for the growth of life insurance.

Mr. JOSEPHS. Well, those years reflect the average that we have experienced in business right along. Let's say they were normal years. They show a recovery, of course, from the very small growth of 1932 and 1933.

Two additional factors may also affect the volume of funds for investment:

1. Each year the life insurance companies receive payment in whole or in part, of some of their holdings as the result of the amortization of principal or changed financial situations. It is not believed, however, that the variation here will be great. While there may be some interruption in anticipated amortization or maturities of outstanding debt, this is substantially offset by the fact that in poor times the stronger corporations tend to utilize their idle cash to retire outstanding debt.

2. It is theoretically possible for this company to withhold investment either by accumulating cash or purchasing short-term temporary investments beyond the needs of liquidity. We do not follow such a course. As funds accumulate above cash requirements, investments are made promptly. During the sharp decline in interest rates in the middle and late 1930's some investors may have temporarily withheld purchasing of long-term securities in the hope of putting money out later under more favorable terms, but generally speaking, that was a time of little demand for senior capital. In any event, such withholding of investment corrects itself. When senior capital is needed, the bid for it is raised and the proceeds of temporary investments become available.

Stability: As has been shown, the volume of life insurance funds for investment is relatively steady and predictable. Custom and law influence the type of investment which will be made. Within these limitations investments are made where the need seems to be the greatest as expressed by the volume of securities offered. Thus, during the war, insurance companies purchased Government bonds both for patriotic reasons and because they were more persistently available than other securities. Since the war, industry has been more insistent in its need for senior capital for expansion, and this need has been supplied in part by life insurance companies.

There are approximately $217,000,000,000 of net Government debt outstanding in the hands of the public. This is the most important factor in the senior capital market and constitutes a great reservoir of investments. It may be compared with the 30 billions or so of corporate securities which come within the limits now regarded as appropriate for life insurance company investment. Twenty years ago the volume of corporate securities was far greater than the entire Federal debt at that time. Private industry, to obtain funds, must offer a rate that is attractive relative to Government securities. Thus the stability of private investments is closely related to the degree of stability of Government bond prices—not necessarily a pegged price but assuredly an orderly market.

If new accumulations of money by insurance companies are insufficient to meet the legitimate demands for private capital, Government bonds will be sold to meet these needs. In fact, the very large demands for private senior capital in the postwar reconstruction period were met in part by the life-insurance companies not only through their accumulation of new cash but also by the sale of Government bonds. In this way needed expansion of public-utility service to the Nation, as well as industrial construction deferred during the war, was promptly accomplished.

It is our view that there has not been any shortage of outlets for savings channeled through life-insurance companies. Indeed, satisfactory offerings including mortgages for new housing have been available in such volume since the end of the war that this company has not only invested its annual cash increment in this direction but has also exchanged for private investments $900,000,000 of Government securities out of its holdings of 2.5 billion dollars. Most other life-insurance companies have made similar exchanges in varying proportions. Under the circumstances it is apparent that there has been no dearth of investment opportunities for life-insurance companies.

The volume of national savings and the requirement for private capital are rarely ever equal during any short interval of time. Consequently, the Government debt held by life-insurance companies or available for purchase by them is the great balance wheel which stabilizes the supply of senior investments of quality and provides, with the participation of the Federal Reserve System, flexibility for senior capital market.

Criticism in public places of life-insurance companies for the sale of Government securities which were bought in part by the Federal Reserve Bank was based on the possible monetary inflationary aspects. Yet capital loans to business from the proceeds of these sales increased the facilities for the production of goods in short supply and postwar operations were expanded. This eventually tended to check rising prices due to the scarcity.

The manager of a portfolio modifies his view with respect to particular private investments because of restrictions which are imposed or may be imposed in the future. These restrictions are legal or practical.

Legal restrictions are those imposed by State laws. This company operates under the laws of the State of New York and finds no serious obstacle to the making of desired investments. There are some regulations with respect to the purchasing of and accounting for preferred stocks which result in their not being bought as freely by this company as would be the case if we were left to our own investment judgment. This is an example of the danger inherent in detailed regulations.

Practical restrictions include the dictates of custom, the fears of the unpredictable, and the rumors of the market place from which no one is immune. Past or anticipated legislation may drive capital away from certain industries. Illustrative examples can be found in direct subsidies of competitive transportation and their effect on the earnings of railroads. A change in the income-tax law, excise taxes or in rates of depreciation and depletion allowed for tax purposes will have marked effect on the investor's appraisal of particular investments, regardless of the merits of such changes made to accomplish other desired aims.

Government policies adopted for one advantageous purpose may have a byproduct effect unfavorable to private enterprises. Investment thrives only in an atmosphere of confidence. Although an individual may be bold with his own funds, he cannot behave with the same freedom with respect to trust funds. Consequently, the funds of life insurance are most freely invested in a climate congenial to the protection of private capital. Abrupt social changes disturb the investor. Fears of inflation or deflation make capital hesitant. Thus, unbalanced budgets, large expenditures for armed forces, necessitous subsidies for reasons of defense, to give a few examples, tend to affect the attractiveness of private investments.

The managers of portfolios endeavor to find new fields for the outlet of funds. Sometimes a change of law permits this, such as direct investment in housing or purchase and lease back of industrial and commercial properties. But custom and public criticism are more often a deterrent from entering new fields, such as, for example, the reluctance to advocate the purchase of common stocks.

Many who have considered this matter carefully believe that the portfolios of life-insurance companies would be better balanced and diversified by an inclusion of a judicious mixture of common stocks. More than half of the States permit this type of investment under a variety of restrictions, but the companies rarely approach the modest limits which have been established. The effective restraint is probably not one of law but one of custom. The value of certain life-insurance assets has long been associated with market quotations as a standard of worth, and thus the volatile nature of common-stock prices is emphasized unduly. Quotations do not always rise, and management avoids a course which might possibly disturb policyholders. The attitude of policyholders is reinforced by the current search for security which is expressed in so many facets of our national life.

It is worth noting another restriction imposed by custom to the purchase of common stocks. The public is jealous of the control of our corporations and the purchase in quantity of voting stock by a life-insurance company might not meet with favor. The size of a purchase ordinarily made by a life-insurance company, even though the holding be only a small proportion of the shares outstanding, might be disturbing. In England the public has become accustomed to such transactions but in this country it might be subject to criticism. In any event opinion has not yet fully crystallized and the subject of common stocks as an appropriate investment for insurance funds well deserves further study.

It is our conviction that minimum regulations of the broadest nature are the best road to providing capital for private needs. It has been our observation that the self-imposed prudence of men in positions of trust, where their policies and actions are always in the public view, is the finest type of regulation.

Certain broad limitations are now established by law. Any attempt to substitute detailed mathematical standards or statistical hurdles for ripe judgment would do more harm than good. Blunt tools aimed at limiting the possible errors of a foolish person would restrict many investor's intelligent adjustment to new conditions. Investing is an art that cannot be reduced to rules. There is no alternative for the careful judgment and thorough knowledge of those who have been trained. Not only are detailed regulations restrictive when they are enacted but they tend to lag far behind economic and financial changes and so give a false sanction to actions which are long out of date.

If there are no artificial obstructions capital will flow toward—managers of portfolios will select—the most attractive outlets as they develop. Again, if unobstructed, these outlets will steadily adjust themselves in relationship with each other. The secret of stability, therefore, does not lie in the decisions of those that furnish capital but in the nature of the outlets.

Technological and industrial growth generally create instability. There is little that can be done to remove these sources of instability. There are other obstacles to the free flow of investments which should be considered. They do not result from laws enacted to control investment action, but are almost wholly the byproducts of legislation for other purposes.

We are particularly concerned about two byproducts of recent Government policy. The first of these has to do with the maintenance of low interest rates. Life-insurance companies receive savings from the most prudent section of our American society. They invest in the private-enterprise system, of which policyholders in particular are among the most self-reliant members.

Although, as previously indicated, the volume of savings channeled through life insurance has been relatively stable in the past, we must warn that this constructive institution of life insurance can be destroyed if the rewards of thrift become unattractive. Yet it has been the firm policy of the Government to keep interest rates down in order that the Government may refund and borrow cheaply. The byproduct effect is to make life insurance less attractive. Since such large savings for private needs come from this source, we are deeply concerned lest this important contribution to our economic system be curtailed.

Our second concern has to do with inflation. The reserves of life-insurance companies stem from the patient accumulation of the thrifty element of our population. That element is seriously disturbed because of the decreasing purchasing power of the sums which they have laid aside in the past and the possibility of even a more serious debasement of the sums which they are putting aside now. We have a duty to speak for them when their interests are so seriously affected. Unbalanced budgets may be caused by unavoidable costs of Government for which we have not levied on ourselves sufficient taxes or by establishing new social benefits for which we are not yet willing to pay. The inflationary effects of these budgetary deficits is a byproduct of national policy which may destroy part of the purchasing power of the savings of our policyholders and the payments made to their beneficiaries.

In the final analysis, these byproducts of Government policy are the greatest factors affecting the volume and stability of private investments.

In brief, the assets of life-insurance companies represent a substantial proportion of the accumulated savings of the American people. The annual volume of savings through life insurance is relatively stable and can be forecast over a period of years.

Today Government securities are the dominant factor in the senior security market and provide a reservoir which tends to stabilize it.

Life-insurance companies do not create a demand for their funds, but choose from those investments offered by the economy.

Although there is no shortage of investment outlets for life-insurance companies, now is an appropriate time to study further investment in common stocks.

Two important byproducts of recent Government policy concern us:

1. Maintenance of low interest rates which discourage savings.

2. Continued Government deficits through their inflationary effects diminish the purchasing power of savings and destroy the thrift impulse.

(The statistical data submitted by Mr. Josephs are as follows:)

New York Life Insurance Co.

Question B.—Geographic distribution of investments and estimated reserve liabilities, Dec. 31, 1948

	Real estate, including rental housing and business properties	Mortgage loans, including property held subject to redemption	Policy loans	Railroad bonds		Government, State, Province, county, and municipal bonds	Public utility bonds
				Intrastate	Interstate		
Alabama		$6,316,927.45	$2,516,163.08		$1,619,403		$10,722,079
Alaska		132,568.24	497,691.91				
Arizona		238,724.40	1,940,834.04		2,712,162	$20,010	364,349
Arkansas		2,160,989.07	1,211,043.92		2,121,790		15,098,761
California	$894,422.39	21,989,054.35	21,029,141.08	$3,965,654	9,211,047		99,611,006
Colorado		1,752,370.71	1,660,680.54		3,030,483		13,369,514
Connecticut		3,713,765.20	1,432,047.61		3,525,794		6,313,537
Delaware		3,098,750.03	293,254.99		394,739		1,866,285
District of Columbia		18,524,288.95	2,149,127.74				2,661,124
Florida		11,090,510.44	5,254,483.66		371,405		3,047,315
Georgia		17,060,393.99	2,955,177.81	668,055	2,327,632		6,872,077
Hawaii			387,069.12				
Idaho			822,072.66		434,834		476,423
Illinois	1,686,948.95	25,438,513.29	13,397,884.35	8,652,397	12,512,005		63,783,398
Indiana		6,213,066.55	2,126,945.75		18,278,014		27,694,764
Iowa		1,251,423.72	2,478,186.87		2,663,029		6,368,290
Kansas	4,016,366.59	2,890,149.32	1,685,482.61		9,019,010		7,152,089
Kentucky		2,438,241.31	1,722,170.77	230,022	3,708,476		8,630,772
Louisiana		6,720,977.65	2,860,642.87	856,760	1,628,888		14,036,603
Maine			836,069.61		11,361		4,093,586
Maryland		4,340,403.19	2,276,071.52		3,438,256	3,598,693	16,421,000
Massachusetts		3,206,373.53	4,296,164.06		2,076,850		25,129,968
Michigan	210,722.09	12,274,902.01	3,512,861.58		7,057,553		37,473,853
Minnesota	8,200.00	2,916,691.40	3,389,310.84	1,901,078	4,220,043		8,759,179
Mississippi		3,158,091.40	3,587,720.95		724,289		4,755,975
Missouri		4,586,307.59	2,121,075.48		2,562,939		25,481,632
Montana		109,123.60	823,630.59		3,707,194		7,317,120
Nebraska		266,937.53	892,857.53		2,888,527		2,413,506
Nevada			1,320,987.75		3,404,541		894,183
New Hampshire			290,173.79		74,658		2,100,478
New Jersey	4,296,310.61	15,245,557.70	10,797,608.41	4,006,024	930,837		31,654,518
New Mexico		137,419.05	848,736.80	461,561	3,220,580		1,396,650
New York	80,852,996.91	127,899,068.66	17,359,711.95	7,914,062	6,670,344	32,483,116	117,331,091
North Carolina		3,780,577.54	2,054,082.21		3,435,975		6,265,359
North Dakota		50,610.00	889,872.41		2,925,251		485,055
Ohio		19,101,366.18	5,816,820 57	7,546,944	11,784,243		40,586,925
Oklahoma		4,641,628.93	2,615,689.04		2,585,093		10,720,360
Oregon	1,268,331.40	9,551,990.46	1,561,478.45		583,267		5,187,330

Pennsylvania	1,402,563.01	37,254,049.64	7,792,310.53	5,263,867	8,581,976	8,017,010	61,986,628
Rhode Island			461,855.13		726,517		7,874,565
South Carolina		4,772,507.06	1,930,403.14		1,844,927	323,477	909,906
South Dakota		76,945.00	441,082.75		2,596,256		207,880
Tennessee		5,670,833.03	2,347,595.64	800,249	2,822,433	411,637	5,199,363
Texas		19,316,435.83	4,195,575.18	330,000	6,656,582		35,344,731
Utah		559,719.84	1,022,588.11		1,319,880		1,295,285
Vermont			352,797.14		8,115		1,944,884
Virginia	6,245.12	28,820,364.92	2,728,275.83	383,057	2,807,534		1,213,744
Washington		18,794,316.14	2,790,552.21		2,956,344		8,139,201
West Virginia		1,622,330.17	880,976.77		5,060,907		4,632,793
Wisconsin		190,986.11	2,305,517.89		2,728,087		11,552,598
Wyoming		288,568.77	1,169,349.31		1,066,295		283,382
U. S. Government						1,968,323,386	
Not divisible							327,037
Total	94,643,107.07	459,573,759.95	160,129,904.55	42,979,730	175,036,365	2,013,177,329	777,448,151
Canada		4,523,782.73	3,825,807.12	50,451	1,135,947	67,427,076	11,171,376
Other foreign [1]			680,186.97			79,934	
Grand total	94,643,107.07	464,097,542.68	164,635,898.64	43,030,181	176,172,312	2,080,684,339	788,619,527

[1] Except for $79,934 Mexican bonds on deposit with U. S. of Mexico this line represents, as to Securities, an allocation of foreign assets of U. S. domestic corporation.

	Industrial and miscellaneous bonds	Stocks	Cash	Total investments in State	Total investments in State, including U. S. Government bonds allocated on population basis	Estimated reserves for policy liabilities
Alabama	$665,345	$731,663	$140,437.67	$22,712,018.20	$60,948,052.20	$39,810,000
Alaska	573,658			1,203,918.15	2,183,985.15	5,940,000
Arizona		122,154	35,743.40	5,433,976.84	14,348,557.84	25,980,000
Arkansas	40,654	6,340	64,912.03	20,704,490.02	46,548,720.02	26,050,000
California	28,619,736	3,768,516	1,888,766.32	190,906,343.14	325,578,274.14	372,120,000
Colorado	351,307	700,034	157,011.14	21,021,400.39	36,662,193.39	44,370,000
Connecticut	3,047,689	1,277,320	93,982.61	19,404,135.42	46,402,964.42	21,780,000
Delaware	141,888	5,649,827	30,539.64	11,475,283.66	15,462,678.66	5,440,000
District of Columbia	80,281	4,650	74,035.27	23,493,506.96	35,549,671.96	24,070,000
Florida	960,295	238,788	142,808.70	21,105,605.80	52,736,257.80	49,540,000
Georgia	5,624,278	159,271	484,155.83	36,151,040.63	78,146,235.63	37,980,000
Hawaii	1,038,290		24,525.99	1,449,885.11	7,142,328.11	7,930,000
Idaho	589,147	34,604	20,545.34	2,377,626.00	9,493,180.00	13,830,000
Illinois	11,593,266	7,613,678	2,369,266.21	147,047,356.80	263,447,081.80	292,010,000
Indiana	22,435,642	3,286,062	100,477.34	80,134,911.64	132,615,479.64	39,590,000
Iowa	2,545,029	242,194	170,328.93	15,718,481.52	50,960,612.52	74,490,000

New York Life Insurance Co.—Continued

Question B.—Geographic distribution of investments and estimated reserve liabilities, Dec. 31, 1948—Continued

	Industrial and miscellaneous bonds	Stocks	Cash	Total investments in State	Total investments in State, including U. S. Government bonds allocated on population basis	Estimated reserves for policy liabilities
Kansas	$3, 229, 306	$1, 304, 968	$28, 722. 82	$29, 326, 094. 34	$55, 747, 623. 34	$46, 090, 000
Kentucky	1, 947, 732	900, 586	60, 224. 56	19, 638, 224. 64	57, 484, 917. 64	21, 730, 000
Louisiana	1, 111, 519	300, 891	104, 115. 68	27, 620, 398. 20	62, 204, 676. 20	61, 200, 000
Maine	20, 147	91, 829	33, 011. 59	5, 086, 004. 20	17, 169, 021. 20	23, 550, 000
Maryland	13, 407, 389	2, 435, 552	22, 217. 86	45, 939, 582. 57	74, 777, 715. 57	30, 830, 000
Massachusetts	8, 375, 633	894, 273	193, 708. 00	44, 172, 969. 59	107, 514, 826. 59	85, 200, 000
Michigan	18, 704, 979	10, 854, 401	89, 809. 68	90, 179, 081. 36	173, 350, 511. 36	82, 740, 000
Minnesota	3, 971, 759	2, 699, 138	684, 958. 53	28, 550, 357. 77	68, 021, 544. 77	73, 750, 000
Mississippi	1, 422, 503	47, 624	55, 669. 65	13, 751, 873. 00	42, 227, 515. 00	23, 340, 000
Missouri	1, 325, 595	2, 363, 097	1, 359, 069. 81	39, 779, 715. 88	92, 790, 455. 88	93, 840, 000
Montana	24, 000	2, 043	40, 437. 10	12, 023, 548. 29	18, 884, 016. 29	28, 040, 000
Nebraska	357, 448	788, 947	127, 090. 02	7, 735, 313. 68	25, 201, 985. 08	37, 960, 000
Nevada	----------	----------	----------	5, 619, 711. 75	7, 526, 145. 75	10, 380, 000
New Hampshire	20, 327	----------	23, 011. 19	2, 508, 647. 98	9, 865, 863. 98	8, 010, 000
New Jersey	9, 660, 633	4, 169, 680	129, 689. 06	80, 890, 857. 78	144, 38u, 398. 78	83, 740, 000
New Mexico	226, 105	213, 312	22, 402. 16	6, 526, 766. 01	14, 192, 769. 01	15, 560, 000
New York	23, 645, 307	9, 708, 949	39, 105, 580. 20	462, 970, 226. 72	656, 110, 531. 72	702, 790, 000
North Carolina	6, 992, 033	4, 209, 923	92, 032. 81	26, 829, 982. 56	76, 705, 989. 56	34, 430, 000
North Dakota	16, 276	163, 520	82, 613. 86	4, 613, 198. 27	12, 131, 519. 27	18, 950, 000
Ohio	34, 829, 511	3, 056, 452	302, 008. 14	123, 024, 269. 89	227, 730, 319. 89	143, 290, 000
Oklahoma	5, 582, 748	265, 555	87, 538. 40	26, 498, 612. 37	58, 209, 817. 37	49, 530, 000
Oregon	823, 874	185, 094	323, 429. 73	19, 484, 795. 04	41, 314, 778. 04	35, 590, 000
Pennsylvania	21, 192, 887	9, 890, 681	803, 670. 44	162, 185, 642. 62	305, 691, 600. 62	177, 940, 000
Puerto Rico	----------	9, 000	----------	9, 000. 00	9, 000. 00	----------
Rhode Island	676, 610	9, 107	14, 393. 30	9, 763, 047. 43	19, 805, 376. 43	10, 490, 000
South Carolina	249, 023	171, 300	116, 612. 22	10, 318, 155. 42	37, 048, 473. 42	20, 700, 000
South Dakota	17, 276	119, 847	40, 240. 63	3, 499, 527. 38	11, 863, 661. 38	20, 000, 000
Tennessee	1, 781, 174	1, 366, 552	528, 334. 44	20, 928, 171. 11	63, 205, 303. 11	42, 260, 000
Texas	5, 305, 659	967, 063	934, 918. 14	73, 050, 964. 15	170, 117, 863. 15	8, 350, 000
Utah	437, 027	263, 369	242, 199. 44	5, 140, 068. 39	13, 933, 819. 39	24, 440, 000
Vermont	260, 147	9, 000	31, 491. 39	2, 606, 435. 03	7, 627, 600. 03	10, 530, 000
Virginia	1, 708, 859	2, 820, 681	401, 144. 39	40, 889, 905. 26	81, 555, 968. 26	32, 020, 000
Washington	2, 840, 592	281, 570	649, 586. 10	36, 452, 161. 45	69, 841, 563. 45	69, 580, 000
West Virginia	1, 681, 307	1, 159, 487	108, 143. 58	15, 145, 944. 52	40, 855, 918. 52	26, 490, 000
Wisconsin	1, 623, 819	2, 384, 336	342, 046. 92	21, 136, 390. 92	65, 561, 614. 92	108, 660, 000
Wyoming	356, 241	340, 382	10, 743. 54	3, 514, 961. 62	7, 206, 994. 62	11, 700, 000

U. S. Government				1, 968, 323, 386. 00		
Not divisible	90, 891, 136	16, 554, 348		107, 772, 521. 00	107, 772, 521. 00	
Total	343, 032, 086	104, 857, 658	52, 988, 403. 30	4, 223, 866, 493. 87	4, 223, 866, 493. 87	3, 354, 630, 000
Canada	1, 772, 395	399, 341	822, 938. 81	91, 129, 114. 66	91, 129, 114. 66	54, 550, 000
Other foreign [1]	63, 883, 844	954, 317		65, 598, 281. 97	65, 598, 281. 97	1, 070, 000
Miscellaneous				165, 930. 84	165, 930. 84	
Grand total	408, 688, 325	106, 211, 316	53, 811, 342. 11	4, 380, 759, 821. 34	4, 380, 759, 821. 34	3, 410, 250, 000

Except for $79,934 Mexican bonds on deposit with United States of Mexico this line represents, as to Securities, an allocation of foreign assets of U. S. domestic corporation.

Question C.—Investments by requested group classifications (as of Sept. 30, 1949)

1. Manufacturing		$407, 950, 522. 30
2. Trade		126, 968, 165. 13
3. Electricity, gas, water, and telephone		875, 983, 215. 60
4. Railroads		222, 655, 054. 75
5. Other transportation		138, 886, 000. 00
6. Single to 4-family residence real-estate mortgages		261, 600, 396. 00
7. Multifamily residence real-estate mortgages		148, 614, 837. 00
8. Multifamily real-estate direct investments		66, 189, 946. 97
9. Mortgages on commercial real estate, etc		105, 079, 651. 00
10. Mining, including oil and gas		50, 948, 353. 00
11. U. S. Government		1, 657, 642, 750. 00
12. Securities issued by public authorities other than U. S. Government:		
Domestic:		
Bridge revenue	$3, 481, 000	
Turnpike revenue	7, 945, 000	
Electric plant	1, 545, 000	
Housing	5, 000, 000	
Sewer	305, 000	
Water service, rapid transit and dock	28, 954, 000	
General purposes	430, 000	
		47, 660, 000. 00
Canadian:		
Harbor Commission	250, 000	
General purposes	88, 557, 333	
		88, 807, 333. 00
Foreign (United States of Mexico) general purposes		825, 315. 00
13. International Bank for Reconstruction and Development		24, 381, 000. 00

NOTE.—Bonds at par value, mortgages at face value, stocks at cost, housing at asset value.

Questions D1–D5.—Analysis of loans to industry by companies, as of Sept. 30, 1949

Company	Location	Size (par value)	Product	Purpose	Rate (percent)
PUBLIC UTILITY					
Cities Services Co	Oil, all United States except west coast; natural gas, Southwest; electric, East, Southwest.		Oil, natural gas, electricity		
Debentures, 5's, 1958		$898,500		Refunding	4.37
Debentures, refunding, 5's, 1966		1,390,500		do	4.74
Debentures, 5's. 1969		2,947,000		do	4.62
Cities Service Gas Co	Midwest		Natural gas		
First mortgage, pipe line, 2⅞'s, 1965		2,950,000		Redemption and acquisition	2.81
First mortgage, pipe line, 3⅛'s, 1968		2,000,000		New construction	3.07
Columbia Gas System, Inc	Eastern United States		Natural gas		
Debentures, 3⅛'s, 1971		6,187,000		Redeem debentures, preferred, and notes.	3.12
Eastern Tennessee Natural Gas Co	Tennessee		Natural gas		
First mortgage, pipe line, 3⅝'s, 1969		1,200,000		New construction	3.63
Oklahoma Natural Gas Co	Oklahoma		Natural gas		
First mortgage, 2⅞'s, 1964		5,000,000		New construction	2.75
Debentures, 3¼'s, 1969		2,500,000		do	3.25
Southern Natural Gas Co	South, Southwest		Natural gas		
First mortgage, pipe line, 3's, 1968		5,077,000		New construction	2.95
Tennessee Gas Transmission Co	East, South		Natural gas		
First mortgage, pipe line, 2¾'s, 1966		2,096,000		Refunding	2.65
First mortgage, pipe line, 3's, 1967		4,206,000		New construction	2.85
First mortgage, pipe line, 3's, 1969		20,000,000		do	2.99
Texas Eastern Transmission Co	East, Central, South		Natural gas		
First mortgage, pipe line, 3½'s, 1962		18,000,000		Purchase of pipe line	3.41
First mortgage, pipe line, 3⅝'s, 1962		3,600,000		New construction	3.65
Texas Gas Transmission Corp	Central, South		Natural gas		
First mortgage, pipe line, 3⅝'s, 1968		6,000,000		New construction	3.63
Transcontinental Gas Pipe Line Corp	East, South		Natural gas		
First mortgage, pipe line, 3⅝'s, 1968		25,000,000		New construction	3.63
United Gas Corp	South, Southwest		Natural gas		
First mortgage and collateral trust, 2¾'s, 1967		7,070,000		Refunding and new construction	2.75
American Telephone & Telegraph Co. (parent company).	Total, United States		Telephone service		
Debentures, 2⅝'s, 1986		5,000,000		New construction	2.59
Debentures, 2¾'s, 1970		30,000,000		General purposes	2.82
Debentures, 2¾'s, 1975		15,000,000		Refunding	2.74
Debentures, 2¾'s, 1976		15,000,000		do	2.66
Debentures, 2¾'s, 1980		16,000,000		do	2.75
Debentures, 2¾'s, 1982		20,000,000		New construction	2.71
Debentures, 2⅞'s, 1987		10,000,000		Advances to subsidiaries, new construction.	2.79
Debentures, 3⅜'s, 1973		5,000,000		do	3.26
Bell Telephone of Canada	Ontario, Quebec		Telephone service		
First mortgage, E, 3's, 1977		1,000,000		New construction	2.87
First mortgage, D, 3¼'s, 1964		10,000,000		Refunding	3.13

Bell Telephone of Pennsylvania	Pennsylvania		Telephone service		
First and refunding mortgage, C, 5's, 1960		5, 142, 000		Refunding and construction	4. 86
Carolina Telephone & Telegraph Co	North Carolina		Telephone service		
Debentures, 2¾'s, 1977		750, 000		New construction	2. 75
Debentures, 3⅛'s, 1978		1, 500, 000		do	3. 00
Illinois Bell Telephone Co	Illinois		Telephone service		
First mortgage, A, 2¾'s, 1981		2, 000, 000		Refunding and new construction	2. 70
First mortgage, B, 3's, 1978		6, 000, 000		Repay advance from parent	2. 86
Mountain States Telephone & Telegraph Co	Mountain States		Telephone service		
Debentures, 2⅝'s, 1986		1, 500, 000		Refunding; pay off advances	2. 64
Debentures, 3⅛'s, 1978		2, 500, 000		Repay advances	3. 07
New England Telephone & Telegraph Co	New England		Telephone service		
First mortgage, D, 2¾'s, 1975		3, 900, 000		Refunding	2. 75
Debentures, 3's, 1982		3, 000, 000		Pay-off construction advances	2. 92
First mortgage, B, 4½'s, 1961		3, 375, 000		do	4. 82
New York Telephone Co	New York		Telephone service		
First and refunding mortgage, D, 2¾'s, 1982		15, 000, 000		Repay notes; construction	2. 65
First and refunding mortgage, F, 3's, 1981		20, 000, 000		Repay banks; construction	2. 96
First and refunding mortgage, E, 3⅛'s, 1978		4, 539, 000		Repay notes; construction	3. 05
Pacific telephone & Telephone Co	Far West		Telephone service		
Debentures, 2¾'s, 1985		1, 500, 000		Refunding; new construction	2. 64
Debentures, 2⅞'s, 1986		10, 000, 000		Pay-off advances; construction	2. 73
Debentures, 3⅛'s, 1983		25, 000, 000		do	
Debentures, 3⅛'s, 1987		7, 740, 000		New construction	3. 07
Southern Bell Telephone & Telephone Co	South		Telephone service		
Debentures 2¾'s, 1985		3, 150, 000		Refunding	2. 70
Debentures, 2⅞'s, 1987		10, 000, 000		Pay-off notes; construction	2. 75
Southern New England Telephone Co	Connecticut		Telephone service		
Debentures, 3⅛'s, 1978		1, 500, 000		Repay advances for construction	3. 10
Debentures, 2¾'s 1980		2, 500, 000		Refunding	2. 72
Southwestern Bell Telephone Co	Southwest		Telephone service		
Debentures 3⅛'s, 1983		9, 600, 000		Pay-off advances; construction	3. 00
Associated Telephone Co	Southern California		Telephone service		
First mortgage, 3⅛'s, D, 1977		1, 000, 000		Pay-off loans; new construction	3. 07
First mortgage, 3⅜'s, E, 1978		1, 000, 000		do	3. 25
Indiana Associated Telephone Co	Indiana		Telephone service		
First mortgage, 3's, 1975		252, 000		Refunding	2. 82
Lincoln Telephone & Telegraph Co	Nebraska		Telephone service		
First mortgage, A, 2¾'s, 1976		1, 250, 000		Repay bank loan; new construction	2. 75
Ohio Associated Telephone Co	Ohio		Telephone service		
First mortgage, 3's, 1976		500, 000		Refunded bonds, bank loans and preferred.	2. 90
First mortgage, 3¼'s, 1979		309, 000		Repay construction loans	3. 20
Pennsylvania Telephone Corp	Pennsylvania		Telephone service		
First mortgage, 2⅞'s, 1975		704, 000		Refunding, general purposes	2. 75
Alabama Power Co	Alabama		Electricity		
First mortgage, 3⅜'s, 1978		1, 000, 000		New construction	3. 22
First mortgage, 3½'s, 1972		1, 871, 000		Refunding	3. 40
Arkansas Power & Light Co	Arkansas		Electricity		
First mortgage, 2⅞'s, 1977		4, 265, 000		New construction	2. 86
First mortgage, 3⅛'s, 1978		3, 000, 000		do	3. 07
Atlantic City Electric Co	New Jersey		Electricity		
First mortgage, 3¼'s, 1964		1, 000, 000		Refunding	3. 19

Questions D1–D5.—Analysis of loans to industry by companies, as of Sept. 30, 1949—Continued

Company	Location	Size (par value)	Product	Purpose	Rate (percent)
PUBLIC UTILITY—continued					
Birmingham Electric Co	Alabama		Electricity		
First mortgage, 3's, 1974		$972,000		Refunding	2.95
Birmingham Water Works Co	Alabama		Water		
First mortgage, A, 3½'s, 1964		1,500,000		Refunding	3.25
Boston Edison Co	Massachusetts		Electricity		
First mortgage, series A, 2¾'s, 1970		3,048,000		Refunding	2.62
California Water Service	California		Water		
First mortgage, 3¼'s, 1975		1,940,000		Refunding and new construction	3.10
Carolina Power & Light Co	North Carolina and South Carolina.		Electricity		
First mortgage, 3⅛'s, 1979		3,000,000		Retire bank loans and new construction.	3.02
First mortgage, 3¾'s, 1965		1,917,000		Refunding	3.53
Central Hudson Gas & Electric Co	New York		Electricity and gas		
First mortgage, 3's, 1970		850,000		New construction	2.95
Central Main Power Co	Maine		Electricity and gas		
First mortgage and general R, 3's, 1979		2,000,000		New construction	2.97
First mortgage and general Q, 3⅛'s, 1978		1,854,000		do	3.05
Central New York Power Corp	New York		Electricity and gas		
General, 3's, 1974		2,239,000		Refunding	2.88
Utica Gas & Electric Co	New York		Gas and electric		
Refunding and extension, 5's, 1957		200,000		Refunding and new construction	4.92
Central Power & Light Co	Texas		Electricity		
First mortgage, B, 3¼'s, 1977		1,500,000		New construction	3.17
Cincinnati Gas & Electric Co	Ohio		Electricity and gas		
First mortgage, 2⅞'s, 1978		5,000,000		New construction	2.82
Columbus & Southern Ohio Electric Co	Ohio		Electricity		
First mortgage, 3¼'s, 1970		936,000		Refunding	2.89
Commonwealth Edison Co	Illinois		Electricity		
First mortgage, L, 3's, 1977		5,826,000		Refunding	2.78
First mortgage, N, 3's 1978		18,530,000		New construction	2.95
First mortgage, M, 3's 1985		8,000,000		Refunding	2.92
Consolidated Edison Co. of N. Y., Inc.—Company only.	New York		Electricity and gas		
First mortgage and refunding B, 2⅝'s, 1977		5,000,000		Refunding	2.59
First mortgage and refunding C, 2¾'s, 1972		5,000,000		do	2.64
First mortgage and refunding A, 2¾'s, 1982		20,000,000		do	2.62
First mortgage and refunding E, 3's, 1979		13,000,000		Refunding and new construction	2.90
The Yonkers Electric Light & Power Co	New York		Electricity		
Debentures, guaranteed 2⅝'s, 1976		1,800,000		Refunding	2.63
Westchester Lighting Co	New York		Gas and electricity		
First mortgage, guaranteed 5's, 1950		354,000		General corporation	4.94

Consolidated Telephone & Electric Subway Co	New York		Ducts for electric cables		
Debentures, 2⅞'s, 1960		2,500,000		Refunding	2.73
Consolidated Gas, Electric Light & Power Co. of Baltimore.	Maryland		Electricity and gas		
First mortgage, refunding S, 3's, 1978		13,466,000		Refunding	2.95
Consumers Power Co	Michigan		Electricity		
First mortgage, 2⅞'s, 1975		3,611,000		Refunding	2.83
First mortgage, 2⅞'s, 1977		5,650,000		New construction	2.77
Dallas Power & Light Co	Texas		Electricity, power, and light		
First mortgage, 3½'s, 1967		1,000,000		Refunding	3.36
Delaware Power & Light Co	Delaware		Electricity		
First mortgage, and collateral 3⅛'s, 1977		1,835,000		New construction	3.03
Detroit Edison Co	Michigan		Electricity		
General and refunding, T, 2¾'s, 1982		10,000,000		Refunding	2.70
General and refunding, H, 3's, 1970		5,000,000		do	2.65
General and refunding, G, 3½'s, 1966		5,669,000		do	3.16
Duquesne Light Co	Pennsylvania		Electricity		
First mortgage, 2¾'s, 1977		2,175,000		Refunding	2.73
East St. Louis & Inter Water Co	Illinois		Water		
First mortgage, B, 3¾'s, 1971		1,500,000		Refunding	3.40
Florida Power & Light	Florida		Electricity		
First mortgage, 3's, 1979		5,000,000		Refunding and new construction	2.90
Georgia Power Co	Georgia		Electricity		
First mortgage, 3⅜'s, 1977		1,000,000		New construction	3.30
First mortgage, 3⅜'s, 1978		2,000,000		do	3.24
Houston Lighting & Power Co	Texas		Electricity		
First mortgage, 3's, 1978		9,500,000		New construction	2.99
Illinois Power Co	Illinois		Electricity		
Debentures, 2¾'s, 1966		1,150,000		Refunding	2.65
First mortgage, 2⅞'s, 1976		3,850,000		do	2.75
First mortgage, 2⅞'s, 1979		5,000,000		Refunding and new construction	2.85
Indiana & Michigan Electric Co	Indiana and Michigan		Electricity		
First mortgage, 3's, 1978		5,000,000		Refunding	2.96
First mortgage, 3¼'s, 1969		2,000,000		do	3.10
Indianapolis Power & Light Co	Indiana		Electricity		
First mortgage, 3¼'s, 1970		2,424,000		Refunding	3.02
Indianapolis Water Co	Indiana		Water		
First mortgage, 2¾'s, 1976		5,000,000		Refunding	2.67
First mortgage, 3's, 1975		1,000,000		New construction	2.90
Iowa-Illinois Gas & Electric Co	Iowa, Illinois		Electric, gas		
First mortgage, 2¾'s, 1977		5,000,000		Refunding	2.69
Jersey Central Power & Light Co	New Jersey		Electricity and gas		
First mortgage, 2⅞'s, 1976		1,100,000		Refunding	2.74
Kansas City Power & Light Co	Kansas		Electricity		
First mortgage, 2¾'s, 1976		5,105,000		Refunding	2.68
First mortgage, 2⅞'s, 1978		3,000,000		do	2.82
Kansas Gas & Electric Co	Kansas		Electricity		
First mortgage, 3⅜'s, 1970		1,000,000		Refunding	3.11
Kentucky & West Virginia Power Co	Kentucky and West Virginia.		Electricity		
First mortgage, 3's, 1979		5,000,000		Refunding	2.97

Questions D1–D5.—Analysis of loans to industry by companies, as of Sept. 30, 1949—Continued

Company	Location	Size (par value)	Product	Purpose	Rate (percent)
PUBLIC UTILITY—continued					
Lexington Water Co.	Kentucky		Water		
First mortgage, C, 3's, 1979		$500,000		Refunding and new construction	2.95
First mortgage, B, 3½'s, 1966		750,000		Refunding	3.00
Long Island Lighting Co.	Long Island		Electricity and gas		
First mortgage, 3¼'s, 1972		5,020,000		Refunding	3.25
Queens Borough Gas & Electric Co.	New York		Electricity and gas		
Refunding mortgage, 4's, 1961		1,702,000		Refunding	3.73
Louisville Gas & Electric Co.	Kentucky		Electricity and gas		
First mortgage and refunding, 3½'s, 1966		1,848,000		Refunding	3.39
Metropolitan Edison Co.	Pennsylvania		Electricity		
First mortgage, 3's, 1977		605,000		New Construction	2.93
Monongahela Power Co.	West Virginia, Ohio, Maryland, Virginia.		Electricity		
First mortgage, 3's, 1975		118,000		Refunding	3.03
First mortgage, 3's, 1977		2,000,000		New construction	2.90
First mortgage, 3⅛'s, 1979		2,000,000		do	3.00
Montana Power Co.	Montana		Electricity and gas		
First mortgage, 2⅞'s, 1975		5,619,000		Refunding	2.85
New England Electric System	New England		Electricity, gas, transportation.		
Debentures, 3's, 1967		2,730,000		Refunding	2.90
Debentures, 3¼'s, 1977		9,770,000		do	3.11
Narragansett Electric Co.	Rhode Island		Electric, gas		
First Mortgage, 3's, 1978		2,450,000		New construction	2.95
New England Power Co.	New England		Electricity		
First mortgage, 3¼'s, 1961		69,000		Refunding	3.36
New Orleans Public Service Co.	Louisiana		Electricity, gas, transportation.		
First mortgage, 3⅛'s, 1974		3,000,000		Refunding	2.93
New York Power & Light Co.	New York		Electricity and gas		
First mortgage, 2¾'s, 1975		40,000		Refunding	2.98
New York State Electric & Gas Co.	New York		Electricity and gas		
First mortgage, 2¾'s, 1977		1,148,000		Refunding and new construction	2.65
First mortgage, 3's, 1978		2,000,000		New construction	2.96
First mortgage, 3¼'s, 1971		750,000		Refunding	2.92
Niagara Falls Power Co.	New York		Hydroelectric		
First and refunding mortgage, 3½'s, 1966		720,000		Refunding	3.26
Northern Indiana Public Service Co.	Indiana		Electricity and gas		
First mortgage, C, 3⅛'s, 1973		4,000,000		Refunding	2.98
Northern States Power Co. (Minnesota)	West North Central		Electricity		
First mortgage, 2¾'s, 1975		548,000		Refunding	2.97
First mortgage, 3's, 1978		6,324,000		Financing and new construction	2.93
Northern States Power Co. (Wisconsin)	Wisconsin, Minnesota		Electricity		
First mortgage, 2⅝'s, 1977		2,783,000		Refunding and new construction	2.60

Ohio Edison Co	Ohio		Electricity		
First mortgage, 2¾'s, 1975		134,000		Refunding	2.09
First mortgage, 3⅛'s, 1978		6,000,000		New construction	2.96
Ohio Power Co	Ohio		Electricity		
First mortgage, 3's, 1978		1,942,000		Refunding and new construction	2.96
First mortgage, 3¼'s, 1968		975,000		do	3.18
Ohio Public Service Co	Ohio		Electricity		
First mortgage, 2¾'s, 1976		2,000,000		Refunding	2.70
First mortgage, 3's, 1979		2,000,000		New construction	2.96
First mortgage, 3⅛'s, 1978		2,000,000		do	3.09
Oklahoma Gas & Electric Co	Oklahoma, Arkansas		Electricity		
First mortgage, 3's, 1979		4,945,000		Refunding and new construction	2.90
Pacific Gas & Electric	California		Electricity and natural gas		
First and refunding mortgage, P, 2¾'s, 1981		5,000,000		New construction	2.74
First and refunding mortgage, Q, 2⅞'s, 1980		5,000,000		Repay bank loans and new construction.	2.92
First and refunding mortgage, K, 3's, 1971		2,500,000		Refunding and new construction	2.75
First and refunding mortgage, L, 3's, 1974		4,500,000		Refunding	2.80
First and refunding mortgage, N, 3's, 1977		5,000,000		do	2.75
First and refunding mortgage, S, 3's, 1983		17,489,000		New construction	2.97
First and refunding mortgage, R, 3⅛'s, 1982		10,000,000		Repay bank loans and new construction.	3.10
San Joaquin Light & Power					
Unification and refunding, 6's, 1952		160,000		Refunding, new construction	5.08
Pennsylvania Electric	Pennsylvania		Electricity and steam		
First mortgage, 2¾'s, 1976		3,000,000		Acquisition of property	2.68
First mortgage, 3⅛'s, 1973		500,000		Refunding	2.72
Pennsylvania Power & Light	Pennsylvania		Electricity, gas, and steam		
First mortgage, 2¾'s, 1977		3,800,000		New construction	2.73
Debentures, 3's, 1965		100,000		do	3.10
First mortgage, 3's, 1975		5,000,000		Refunding	2.93
Penn Water & Power	Pennsylvania		Electricity and water		
Refunding and collateral, 3¼'s, 1970		454,000		Refunding	3.00
Philadelphia Electric	Pennsylvania		Electricity and gas		
First and refunding mortgage, 2¾'s, 1974		5,000,000		Refunding	2.75
First and refunding mortgage, 2¾'s, 1981		7,500,000		Refunding; new construction	2.69
Philadelphia Sub. Water	Pennsylvania		Water		
First mortgage, 3's, 1978		1,850,000		New construction	2.98
First mortgage, 3¼'s, 1971		2,500,000		Refunding; working capital	2.97
Potomac Edison	East		Electricity, gas, transportation.		
First mortgage and collateral, Tr., 3⅛'s, 1978		1,000,000		Refunding; acquisitions	3.10
Potomac Electric Power	Washington, D. C., Maryland, Virginia.		Electricity		
First mortgage, 3¼'s, 1966		1,590,000		Refunding; new additions	3.02
Public Service of Colorado	Colorado, Wyoming		Electricity, natural gas		
First mortgage, 2⅞'s, 1977		7,500,000		Refunding	2.71
First mortgage, 3⅛'s, 1978		2,700,000		Refunding, new construction	3.02
Public Service of Indiana	Indiana		Electricity		
First mortgage, H, 3's, 1979		2,000,000		New construction	2.97
First mortgage, F, 3⅛'s, 1975		35,000		Refunding	3.02
First mortgage, G, 3⅛'s, 1977		3,000,000		New construction	3.04

Questions D1–D5.—Analysis of loans to industry by companies, as of Sept. 30, 1949—Continued

Company	Location	Size (par value)	Product	Purpose	Rate (percent)
PUBLIC UTILITY—continued					
Public Service Electric & Gas	New Jersey		Electricity, manufactured gas, transportation.		
First and refunding mortgage, 2⅞'s, 1979		$25,000,000		New construction	2.81
First and refunding mortgage, 3's, 1970		2,500,000		do	2.92
First and refunding mortgage, (standard) 3⅛'s, 1965.		12,500,000		Refunding	3.13
First and refunding mortgage, 3¼'s, 1966		5,000,000		do	3.25
First and refunding mortgage, 3¼'s, 1968		364,000		New construction	3.00
South Jersey Gas, Electric & Traction					
First mortgage, 5's, 1953		500,000		Refunding	5.54
Rochester Gas & Electric	New York		Electric, gas, and steam		
First mortgage, 3's, 1979		5,000,000		Repay bank loans and new construction.	2.97
General mortgage, 3⅜'s, 1970		3,909,000		Refunding	3.24
General mortgage, 3½'s, 1967		120,000		New construction	3.26
General mortgage, 4½'s, 1977		250,000		do	4.53
Savannah Electric & Power	Georgia		Electric		
Debentures, 3⅞'s, 1969		2,500,000		Repay bank loans and new construction.	3.84
Scranton Electric Light	Pennsylvania		Electric and heating		
First, 2⅞'s 1976		2,170,000		Refunding and new construction	2.80
Sioux City Gas & Electric	Iowa		Electric, gas and steam		
First and collateral, 3's, 1978		1,000,000		New construction	3.03
Iowa Public Service Co	Iowa		Electricity		
First mortgage, 2¾'s, 1976		536,000		Refunding	2.97
First mortgage, 3's, 1977		1,000,000		New construction	2.87
First mortgage, 3½'s, 1978		500,000		do	3.15
South Pittsburgh Water Co	Pennsylvania		Water		
First morgage, 3¼'s, 1978		1,300,000		New construction	3.13
First mortgage, 3¾'s, 1964		1,500,000		Refunding and repay parent	3.50
Southern California Edison Co	California		Electric		
First and refunding, 3's, 1965		1,500,000		Refunding	2.80
First and refunding, 3's, 1973		14,891,000		New construction	2.97
First and refunding, 3⅛'s, 1973		5,000,000		Repay bank loans, new construction	3.00
Southwestern Gas & Electric Co	Southwest		Electric		
First mortgage, 3¼'s, 1970		1,932,000		Refunding	3.07
First mortgage, 3's, 1979		2,000,000		Repay bank loans, new construction	2.89
Southwestern Public Service Co	Southwest		Electric gas, and water		
First mortgage, 2⅞'s, 1971		2,910,000		Refunding and purchase of property	2.75
First mortgage, 2¼'s, 1972		490,000		Mew construction	2.85
First mortgage, 3's, 1977		1,366,000		do	2.98
First mortgage, 3¼'s, 1979		1,200,000		do	3.20
Debentures, 3½'s, 1974		1,980,000		New construction, repay notes	3.45

Tampa Electric Co	Florida		Electric, water, and ice		
Debentures, 3's, 1969		4,000,000		New construction	2.90
Terre Haute Water Works	Indiana		Water		
First mortgage, 3¾'s, 1964		500,000		Refunding	3.50
Texas Electric Service	Texas		Electric		
First mortgage, 2⅞'s, 1977		2,000,000		New construction	2.80
First mortgage, 2⅞'s, 1979		1,448,000		do	2.83
Texas Power & Light Co	Texas		Electric		
First mortgage, 2¾'s, 1975		240,000		Refunding	2.99
First mortgage, 3's, 1977		695,000		New construction	2.95
Toledo Edison	Ohio		Electric, gas and heating		
First mortgage, 2⅞'s, 1977		5,000,000		Refunding	2.72
First mortgage, 3's, 1979		1,388,000		New construction	2.94
First mortgage, 3⅛'s, 1978		1,000,000		do	3.00
Tucson Gas, Electric, Light & Power	Arizona		Electric and gas		
First mortgage, 3⅛'s, 1979		3,500,000		Repay bank loans, new construction	3.02
Union Electric Co. of Missouri	Missouri, Iowa, and Illinois		Electric, gas, and transportation.		
First and collateral, 3⅜'s, 1971		5,611,000		Refunding and new construction	2.98
Debentures, 3's, 1968		5,000,000		Repay bank loans, new construction	2.95
United Illuminating Co	Connecticut		Electric		
Debentures, 2⅞'s, 1978		1,000,000		New construction	2.88
Utah Power & Light Co	Mountain States		Electric and heating		
First mortgage, 2¾'s, 1976		972,000		Refunding	2.81
First mortgage, 3's, 1979		2,421,000		New construction	2.94
Virginia Electric & Power Co	Virginia, West Virginia, and North Carolina.		Electric and gas		
First and refunding mortgage, 2⅞'s, 1979		10,000,000		New construction	2.80
West Penn Power Co	Pennsylvania		Electric		
First mortgage, 3¼'s, 1968		3,000,000		Refunding and new construction	3.00
Wichita Water	Kansas		Water		
First mortgage, 3's, 1979		1,450,000		Repay bank loans, new constrtiction	3.00
Wisconsin Electric Power	Wisconsin		Electric, gas, and heating		
First mortgage, 2⅞'s, 1979		1,297,000		New construction	2.83
Wisconsin Gas & Electric Co	Wisconsin		Electric and gas		
First mortgage, 3½'s, 1966		434,000		Refunding and general purpose	3.41
Wisconsin-Michigan Power Co	Wisconsin, Michigan		Electric and gas		
First mortgage, 3's, 1978		150,000		Refunding, repay bank loan	2.98
Wisconsin Power & Light	Wisconsin		Electric, gas, and water		
First mortgage, 3⅛'s, 1978		335,000		Repay bank notes, new construction	3.00
Wisconsin Public Service	Wisconsin and Michigan		Electric, gas, and transportation.		
First mortgage, 2⅞'s, 1979		2,000,000		Repay bank loans and new construction.	2.75
First mortgage, 3⅛'s, 1978		3,000,000		do	3.02
First mortgage, 3¼'s, 1971		2,797,000		Refunding	2.94
RAILROAD					
Atchison, Topeka & Santa Fe Ry. Co	Central and West		Railroad transportation		
Adjustment mortgage, 4, 1995		6,301,000		Not available	3.54

Questions D1–D5.—Analysis of loans to industry by companies, as of Sept. 30, 1949—Continued

Company	Location	Size (par value)	Product	Purpose	Rate (percent)
RAILROAD—continued					
Atchison, Topeka & Santa Fe Ry. Co.					
General mortgage, 4, 1995		$11,541,000		Not available	3.45
Baltimore & Ohio R. R. Co.	Central and East				
First mortgage, series A, 4, 1975		5,000,000		Exchange plan	4.65
Baltimore & Ohio R. R. Co. (Pittsburgh, Lake Erie & West Virginia system).					
Refunding mortgage, Series A, 4, 1980		3,355,000		Exchange plan	4.76
Baltimore & Ohio R. R. Co. (Toledo-Cincinnati division).					
First lien and refunding mortgage, series D, 4, 1985		318,600		Exchange plan	4.82
Baltimore & Ohio R. R.Co.					
First mortgage, series B, 5, 1975		2,943,000		Exchange plan	5.43
Baltimore & Ohio R. R. Co. (Southwestern division)					
First mortgage, series A, 5, 1980		4,112,000		Exchange plan	6.67
Buffalo, Rochester & Pittsburgh Ry. Co.					
Consolidated mortgage, 4½, 1957		395,000		Refunding and betterments	7.76
Boston & Maine R. R. Co.	New England				
First mortgage, series RR, 4, 1960		100,000		Exchange plan	4.88
Boston & Maine R. R. Co.					
Income mortgage, series A, 4½, 1970		146,000		Exchange plan	8.18
Carolina, Clinchfield & Ohio Ry. Co.	Southern				
First mortgage, series A, 4, 1965		1,876,000		Refunding	3.84
Central of Georgia	Southern				
First mortgage, series A, 4, 1995		442,000		Reorganization	6.25
Chesapeake & Ohio Ry. Co.	Southern				
General mortgage, 4½, 1992		4,948,000		Not available	3.96
Hocking Valley Ry. Co.	Southern				
First consolidated mortgage, 4½, 1999		3,154,000		Not available	4.16
Pere Marquette Ry. Co.	Central and East				
First mortgage, series D, 3⅜, 1980		2,294,000		Refunding	3.39
Pere Marquette Ry. Co.					
Equipment trust of 1940, 2 of 49–50		444,000		Acquisition of equipment	1.70
Chicago & Eastern Illinois R. R. Co.	Central				
General mortgage income, 5, 1997		875,300		Reorganization	11.36
Chicago, Indianapolis & Louisville Ry. Co.	Central				
First mortgage income, series A, 4, 1983		1,416,600		Reorganization	6.67
Chicago, Indianapolis & Louisville Ry. Co.					
Second mortgage income, series A, 4½, 2003		1,758,600		Reorganization	9.00
Chicago, Milwaukee, St. Paul & Pacific R. R. Co.	Northwest				
First mortgage, series A, 4, 1994		7,782,900		Reorganization	3.75
Chicago, Milwaukee, St. Paul & Pacific R. R. Co.					
General mortgage income, series A, 4½, 2019		3,626,900		Reorganization	6.82

Chicago, Milwaukee, St. Paul & Pacific R. R. Co.					
General mortgage income, series B, 4½, 2044		2,030,300		Reorganization	8.33
Chicago, Milwaukee, St. Paul & Pacific R. R. Co.					
Equipment trust, series V, 2⅛, 1949-50		274,000		Acquisition of equipment	2.47
Chicago & Northwestern Ry. Co.	Central and West				
First mortgage, series B, 3, 1989		1,922,000		Refunding	3.00
Chicago & Northwestern Ry. Co.					
Second mortgage income, series A, 4½, 1999		1,742,900		Reorganization	7.38
Chicago Union Station Co.	Central		Railroad transportation		
First mortgage, series F, 3⅛, 1963		2,000,000		Refunding	3.08
Chicago & Western Indiana R. R. Co.	Central				
Consolidated mortgage, 4, 1952		4,346,000		Refunding and betterments	4.27
Cincinnati Union Terminal Co.	Central				
First mortgage, series E, 3⅜, 1969		2,923,000		Refunding	3.00
Delaware, Lackawanna & Western	Eastern				
Morris and Essex, first refunding, 3½, 2000		399,000		Not available	6.14
Morris and Essex, construction B, 4½, 1955		182,000		Betterments	6.16
Denver & Rio Grande Western R. R. Co.	West				
First mortgage, series A, 4, 1993		1,012,600		Reorganization	4.71
Denver & Rio Grande Western R. R. Co.					
Income mortgage, series A, 4½, 2018		1,065,600		Reorganization	7.03
Elgin, Joliet & Eastern	Central				
First mortgage, series A, 3¼, 1970		4,848,000		Refunding	3.16
Erie R. R. Co.	Central and East				
First consolidated mortgage, series F, 3⅛, 1990		1,500,000		Refunding	3.09
First consolidated mortgage, series G, 3⅛, 2000		4,500,000		do	3.10
General mortgage income, series A, 4½, 2015		129,500		Reorganization	6.52
Great Northern Ry. Co.	Northwest				
General mortgage, series P, 2¾, 1982		2,102,000		Refunding	2.89
General mortgage, series N, 3⅛, 1990		4,994,000		do	3.14
Gulf Mobile & Ohio R. R. Co.	Southern				
First and refunding mortgage, series B, 4, 1975		338,700		Reorganization	7.31
General mortgage income, series A, 5, 2015		685,800		do	6.76
Equipment trust of 1941, 2.40, 1950-56		455,000		Acquisition of equipment	2.28
Indiana Harbor Belt R. R. Co.	Central				
General mortgage, 4½, 1957		250,000		Refunding	4.77
Louisville & Nashville R. R. Co. (Atlanta, Knoxville & Cincinnati division), 4, 1955.	Southern	2,455,000		Not available	4.57
Louisville & Nashville Terminal Co.					
First mortgage, 4, 1952		500,000		Not available	4.12
Kentucky Central Ry. Co.					
First mortgage, 4, 1987		251,000		Not available	4.46
Nashville, Chattanooga & St. Louis Ry. Co.					
Equipment trust, series D, 2⅛, 1950-51		200,000		Purchase of equipment	2.00
Memphis Union Station Co.	Southern				
First mortgage, 5, 1959		300,000		Not available	4.90
Missouri Pacific R. R. Co.	Southwest				
First and refunding mortgage, series H, 5, 1980		350,000		Betterments	5.43
First and refunding mortgage, series I, 5, 1981		7,340,000		Refunding and betterments	5.48
Equipment trust, series GG, 2¼, 1949-56		2,232,000		Purchase of equipment	2.00
International Great Northern R. R. Co.					
First mortgage, series A, 6, 1952		500,000		Reorganization	7.74

Questions D1–D5.—Analysis of loans to industry by companies, as of Sept. 30, 1949—Continued

Company	Location	Size (par value)	Product	Purpose	Rate (percent)
RAILROAD—continued					
New Orleans, Texas & Mexico Ry. Co.					
First mortgage, series B, 5, 1954		$400,000		Exchange	5.75
New Orleans, Texas & Mexico Ry. Co.			Railroad transportation		
First mortgage, series A, 5½, 1954		553,000		Refunding and betterments	5.98
New York Central R. R. Co.	Central and East				
Consolidated mortgage, series A, 4, 1998		203,000		Exchange	6.56
Refunding and improvement mortgage, series A, 4½, 2013.		3,000,000		Not available	6.72
New York Central & Hudson River R. R. Co.					
Refunding mortgage, 3½, 1997		795,000		Not available	3.78
Michigan Central collateral trust, 3½, 1998		400,000		Not available	5.65
Canada Southern Ry. Co.					
First and refunding consolidated mortgage, series A, 5, 1962.		51,000		Not available	5.11
Chicago, Indiana & Southern R. R. Co.					
First mortgage, 4, 1956		2,250,000		Not available	4.17
Chicago, Indianapolis & St. Louis Short Line Ry. Co.					
First mortgage, 4, 1953		415,000		Not available	4.07
Cleveland, Cincinnati, Chicago & St. Louis Ry. Co.					
General mortgage, series A, 4, 1993		1,500,000		Not available	4.15
Refunding and improvement mortgage, series E, 4½, 1977.		457,000		Refunding	6.72
Jamestown, Franklin & Clearfield R. R. Co.					
First mortgage, 4, 1959		575,000		Not available	5.41
Lake Shore & Michigan Southern Ry. Co.					
First mortgage, 3½, 1997		4,559,000		Not available	3.83
Michigan Central R. R. Co. (Joliet & Northern Indiana R. R. Co.).					
First mortgage, 4, 1957		1,000,000		Not available	4.71
Michigan Central R. R. Co.					
Refunding and improvement mortgage, series C, 4½, 1979.		2,000,000		Refunding	5.49
St. Lawrence & Adirondack					
First 5, 1996		105,000		Not available	6.85
Toledo, Canada Southern & Detroit					
First 4, 1956		1,300,000		Not available	4.09
West Shore, first 4, 2361		1,981,000		do	6.56
New York, Chicago & St. Louis	Central and East				
Refunding 3, 1986		3,500,000		Refunding	2.93
New York, Susquehanna & Western	Eastern				
First refunding, 5, 1937		500,000		Not available	
New York, Susquehanna & Western Terminal					
First 5, 1943		72,000		Not available	5.33

Midland of New Jersey					
First extended 5, 1940		1,000,000		Not available	
New York, New Haven & Hartford	New England				
First and refunding A, 4, 2007		7,250,600		Reorganization	6.15
General Inc., A, 4½, 2022		218,800		do	10.47
Equipment trust No. 1, 1941, 1¾, 1950-51		578,000		Purchase of equipment	1.85
Equipment trust No. 3, 2½, 1958-61		1,045,000		do	2.90
Norfolk Terminal	Southern				
First 4, 1961		400,000		Not available	4.45
Norfolk & Western	Southern				
First consolidated 4, 1996		1,000,000		Not avalalble	3.92
Scioto Valley & New England					
First 4, 1989		390,000		Not available	2.68
Northern Pacific	Northwest				
General lien, land grant 3, 2047		1,665,500 1,032,000(reg.		Not available	4.92 5.00
Prior lien, land grant 4, 1997		1,693,500		do	4.53
Pennsylvania	Central and East				
General A, 4½, 1965		660,000		Not available	4.04
General B, 5, 1968		279,000		do	3.71
General D, 4¼, 1981		1,425,000		New construction	3.47
General E, 4¼, 1984		4,003,000		Refunding	4.09
Consolidated, 4½, 1960		1,686,000		Not available	3.07
Philadelphia, Baltimore & Washington:					
B 5, 1974		803,000		Betterments	3.24
C 4½, 1977		250,000		Not available	3.26
Pittsburgh, Cincinnati, Chicago, & St. Louis					
General A, 5, 1970		35,000		Not available	4.05
General B, 5, 1975		10,000		Refunding	4.14
General E, 3⅜, 1975		1,961,000		do	3.27
Consolidated F, 4, 1953		1,907,000		Not available	3.81
Consolidated G, 4, 1957		198,000			3.98
Consolidated H, 4, 1960		300,000			3.98
Consolidated I, 4½, 1963		425,000			4.29
United N. J. Railroad & Canal					
First 4½, 1979		2,378,000		Not available	3.14
Vandalia consolidated A, 4, 1955		2,090,000			3.90
Vandalia consolidated B, 4, 1957		235,000			4.31
Pennsylvania equipment trust K, 1950-55		1,596,000		Purchase of equipment	1.85
Peoria & Pekin Union	Central				
First A, 5½, 1974		345,000		Betterments and refunding	5.45
Reading Co	Eastern				
First and refunding D, 3⅛, 1995		2,500,000		Not available	3.16
St. Paul Union Depot	Central West				
First and refunding B, 3⅛, 1971		1,891,000		Refunding	2.96
Seaboard Airline	Southern				
Equipment trust C 2⅝, 1958-62		1,000,000		Purchase of equipment	2.95
Southern Pacific	Southwest and West				
First E, 2⅞, 1986		3,024,000		Refunding	3.12
San Francisco Terminal first A, 3⅜, 1975		3,967,000		do	3.40
Central Pacific first B, 3⅝, 1968		5,000,000		do	3.60
El Paso & Rock Island, first 5, 1951	Southwest	460,000		do	4.82

Questions D1–D5.—Analysis of loans to industry by companies, as of Sept. 30. 1949—Continued

Company	Location	Size (par value)	Product	Purpose	Rate (percent)
RAILROAD—continued					
El Paso & Southwestern first and refunding 5, 1965		$409,000		Betterments and refunding	4.84
Southern Railway	Southern				
First consolidated 5, 1994		6,960,000		Reorganization refund and betterments.	4.34
St. Louis division, first 4, 1951		2,630,000		Acquisition of railroad property	4.09
Memphis division, first 5, 1996		155,000		do	5.07
Equipment trust, JJ 2, 1950–51		250,000		Acquisition of railroad equipment	2.00
East Tennessee, Virginia & Georgia consolidated 5, 1956.		666,000		Not available	4.95
Texas & Pacific	Southwest				
First 5, 2000		1,395,000		Not available	4.20
Union Pacific	Central West and West				
Refunding C, 2½, 1991		2,550,000		Refunding	2.83
Debentures, 2⅞, 1976		3,921,000		do	2.84
Wabash General Inc., A 4, 1981	Central East	386,400		Reorganization	4.94
INDUSTRIAL					
Air Reduction	National		Industrial gases		
Debentures, 2¾'s, 1964		4,400,000		Property additions	2.78
Debentures, 2¾'s, 1967		1,500,000		do	2.75
Allied Stores	National		Retail merchandising		
Note 3 ⅛'s, 1967		9,700,000		Working capital	3.13
American Marietta	Midwest, Southwest, and far West.		Paints and varnishes		
Note 3 ⅜'s, 1962		4,465,000		Working capital and refinancing	3.38
American Tobacco	South		Tobaccos		
Debentures, 3's, 1962		2,514,000		Debt retirement and working capital	3.00
Debentures, 3's, 1969		374,000		Working capital	2.90
Bankers Commercial	New York		Finance		
Note 2 ¼'s, 1952		4,000,000		Working capital	2.25
Belding Real Estate	South		Textile		
First mortgage, 3½'s, 1964		540,000		Plant additions	3.50
Beneficial Industrial Loan	National		Finance		
Debentures, 3¼'s, 1964		5,611,000		Working capital	3.12
Bethlehem Steel	National		Steel		
Consolidated mortgage, 2¾'s, 1970		5,000,000		Refunding	2.72
Consolidated mortgage, 2¾'s, 1976		5,000,000		Plant additions	2.75
Consolidated mortgage, 3's, 1979		9,141,000		do	2.97
Black & Decker Manufacturing	Maryland		Hand power tools		
Note 3 ¼'s, 1963		3,000,000		Working capital	3.25
Bristol Myers	East		Drugs		
Debentures, 3's, 1968		594,000		Working capital	2.97

Brunswick Pulp & Paper	Georgia		Paper		
Note 3 ¼'s, 1963		3, 200, 000		Plant additions	3. 25
Buckeye Pipe Line	Great Lakes area		Oil pipe line		
Debentures, 3⅛'s, 1963		5, 000, 000		Plant additions	3. 13
Bullocks, Inc	California		Retail trade		
Note 3's, 1964		10, 000, 000		Working capital and plant additions	3. 00
Celanese Corp. of America	East, Midwest, and Southwest.		Textile		
Debentures, 2.85 percent, 1966		3, 925, 000		Plant additions	2. 85
Debentures, 3's, 1965		2, 984, 000		Plant additions and working capital	2. 86
Champion Paper & Fibre	Midwest		Paper		
Debentures, 3's, 1965		1,'500, 000		Debt retirement	2. 83
C. I. T. Financial	National		Finance		
Debentures, 2⅝'s, 1959		10, 000, 000		Working capital	2. 80
Cities Service Oil Corp	Midwest		Petroleum		
Debentures, 2⅞'s, 1966		4, 646, 000		To retire debt	2. 68
Debentures, 2¾'s, 1967		2, 438, 000		Plant additions	2. 73
Continental Can Co., Inc	National		Containers		
Debentures, 3's, 1965		6, 580, 000		Retire preferred stock	2. 77
Do		3, 500, 000		Working capital	3. 00
Cudahy Packing	Midwest		Meats		
First mortgage 2⅝'s, 1967		2, 000, 000		Debt retirement	2. 68
Duplan Corp	South		Textiles		
Note 3 ⅜'s, 1963		5, 000, 000		Debt retirement and working capital	3. 38
Eastern Gas & Fuel Associates	Northeast		Coal, coke, and manufactured gas.		
First mortgage, 3½'s, 1965		1, 465, 000		Debt retirement	3. 34
Federated Department Stores	East, Midwest, and Southwest.		Retail trade		
Note 3 ¼'s, 1968		14, 850, 000		Working capital	3. 18
Firestone Tire & Rubber	Midwest		Rubber		
Debentures, 2⅝'s, 1972		1, 888, 000		To retire preferred stock	2. 63
Debentures, 3's, 1961		3, 698, 000		Debt reitrement	3. 07
504 Fulton Street, Brooklyn	Brooklyn		Retail trade		
First mortgage, 3¼'s, 1968		$659, 000		Purchase of property	3. 25
525 William Penn Place	Pittsburgh		Bank and office building		
First mortgage, 3½'s, 1980		22, 500, 000		New construction	2. 50–3. 50
Flintkote Co	National		Building materials		
Note, 3's, 1968		6, 000, 000		Working capital	3. 00
General Electric	National		Electrical equipment		
Note, 2.55 percent, 1966		14, 250, 000		Retire debt and working capital	25. 5
General Motors Acceptance	National		Finance		
Note, 1¾'s, 1949–55		7, 800, 000		Working capital	1. 75
Note, 2½'s, 1953		1, 000, 000		do	2. 50
Note, 3's, 1963		15, 000, 000		do	3. 00
General Motors Corp	National		Automotive		
Note, 2½'s, 1976		17, 100, 000		Working capital	2. 52
Gerber Products	Michigan		Processed foods		
Debentures, 3¼'s, 1963		932, 000		Debt retirement and working capital.	3. 25

Questions D1–D5.—Analysis of loans to industry by companies, as of Sept. 30, 1949—Continued

Company	Location	Size (par value)	Product	Purpose	Rate (percent)
INDUSTRIAL—continued					
Glatfelter (P. H.) & Co.	Pennsylvania		Paper		
First mortgage, 3½'s, 1967		$2, 699, 000		Property additions and debt retirement.	3. 50
Goodrich & Co.	National		Rubber		
First mortgage, 2¾'s, 1965		2, 097, 000		Debt retirement and working capital.	2. 72
Grand Rapids Hardware	Michigan		Window hardware		
First mortgage, 4's, 1950–55		215, 000		Debt retirement and working capital.	4. 00
Great Lakes Pipe Line	Midwest		Oil transport		
Debentures, 3⅛'s, 1969		5, 000, 000		Property additions	3. 13
Hammermill Paper Co.	Great Lakes area		Paper		
Debentures, 3's, 1965		454, 000		Plant expansion	2. 84
Household Finance	National		Finance		
Debentures, 3's, 1964		12, 500, 000		Working capital	3. 00
Inland Steel	Illinois		Steel		
First mortgage, 2.65 percent, 1976		9, 750, 000		Debt retirement and property additions.	2. 65
First mortgage, 3's, 1978		7, 406, 000		Property additions	2. 95
Kelsey Holding Co.	New Jersey		Retail trade		
First mortgage, 3½'s, 1971		308, 000		Purchase of property	3. 41
Koppers Co.	Midwest and East		Coke and chemicals		
First mortgage, 3's, 1964		2, 000, 000		Debt retirement	2. 87
Kuhlman Electric	Midwest		Electrical equipment		
Note, 4¼'s, 1956		750, 000		Debt retirement and working capital.	4. 25
Lerner Stores	National		Retail trade		
Debentures, 3's, 1967		2, 910, 000		Debt retirement and working capital.	3. 00
Libby, McNeill & Libby	Midwest		Processed foods		
Debentures, 2⅞'s, 1967		59, 000		Debt retirement and working capital.	2. 84
Debentures, 2⅞'s, 1967		3, 301, 000		Debt retirement and working capital.	2. 84
Note, 3's, 1969		5, 000, 000		Working capital	3. 00
Liggett & Myers Tobacco	South		Tobacco		
Debentures, 5's, 1951		150, 000		Purchase of assets	4. 62
McCall Corp.	Northeast		Publications		
Note, 3's, 1968		2, 371, 000		Property additions	3. 00
May Department Stores	National		Retail trade		
Debentures, 2⅝'s, 1972		2, 550, 000		Working capital	2. 63

Mead Corp.	Midwest and East		Paper		
First mortgage, 3's, 1966		1,000,000		Debt retirement and plant additions.	2.80
Mojud Hosiery	East		Hosiery		
Note, 3's, 1964		1,500,000		Plant additions and working capital.	3.00
Monsanto Chemical	National		Chemicals		
Debentures, 2.65 percent, 1971		9,500,000		Plant additions	2.65
Benjamin Moore	National		Paints		
Note, 3's, 1964		1,500,000		New plant and working capital	2.92
National Dairy Products	Midwest and East		Dairy products		
Debentures, 2¾'s, 1970		1,983,000		Debt retirement	2.65
National Distillers	Midwest and East		Alcoholic beverages		
Debentures, 3⅛'s, 1974		851,000		Refunding and construction	3.05
Do		7,100,000		do	3.05
National Supply	National		Oil-well supply		
Debentures, 2¾'s, 1967		2,717,000		Working capital and refunding	2.70
Niagara Blower	New York		Air-conditioning equipment		
First mortgage, 4's, 1950-54		39,000		Plant additions and working capital	4.00
Oliver Iron Mining	Minnesota		Iron mining		
Note, 1950-53		337,836		General corporate purposes	4.55
Pennsylvania Salt Manufacturing	National		Chemicals		
Note, 3⅛'s, 1964		1,500,000		Plant additions and working capital	3.13
Pepsi-Cola	National		Beverages		
Note, 3's, 1963		4,667,000		Working capital	3.00
Pillsbury Mills	National		Flour milling		
Note, 3¼'s, 1968		11,882,000		Working capital	3.25
Radio Corporation of America	National		Radio, television, and electrical products.		
Note, 3's, 1974		6,667,000		Refinancing and working capital	3.00
Republic Steel	Midwest		Steel		
First mortgage 3's, 1965		4,013,000		Refunding	2.91
Reynolds (R. J.) Co.	South		Tobacco		
Debentures, 3's, 1973		3,451,000		Working capital	3.00
Rich's, Inc.	Georgia		Retail trade		
Note, 2.85 percent, 1950-62		1,500,000		Property additions and working capital.	2.85
Row-Peterson	Illinois		Publishing		
Note, 4's, 1957		416,000		Debt retirement and working capital.	4.00
Sangamo Electric	Midwest		Electrical equipment		
Note, 3¼'s, 1962		1,333,334		Refunding and new construction	3.25
Schenley Industries	Midwest and East		Alcoholic beverages		
Note, 3.20 percent, 1969		8,000,000		Refunding	3.20
Shell-Caribbean Petroleum	Venezuela		Petroleum		
Bonds, 4's, 1968		50,000,000		General corporate purposes	4.00
Sheller Manufacturing Corp.	Midwest and East		Auto parts		
Note, 3¾'s, 1962		1,250,000		Debt retirement and expansion	3.75
Shell Oil Corp.	National		Petroleum		
Debentures, 2½'s, 1971		970,000		Debt retirement and working capital.	2.64
Debentures, 2½'s, 1971		1,950,000		do	2.64

Questions D1–D5.—Analysis of loans to industry by companies, as of Sept. 30, 1949—Continued

Company	Location	Size (par value)	Product	Purpose	Rate (percent)
INDUSTRIAL—continued					
Standard Oil of California	National		Petroleum		
Debentures, 2¾'s, 1966		$3,000,000		Refunding and working capital	2.51
Standard Oil of Indiana	Midwest and East		Petroleum		
Note, 2.90 percent, 1979		10,000,000		General corporate purposes	2.90
Standard Oil (New Jersey)	National		Petroleum		
Debentures, 2¾'s, 1974		3,913,000		Plant expansion and working capital.	2.72
Debentures, 2¾'s, 1974		27,825,000		do	2.72
Sterling Drug	Midwest and East		Drugs		
Note, 3's, 1963		12,000,000		Working capital	3.00
Stetson China	Illinois		Dinnerware		
Note, 4's, 1959		$497,000		Plant additions	4.00
Sun Chemical	National		Chemical		
Debentures, 2¾'s, 1966		1,000,000		Retire preferred and working capital	2.75
Sunray Oil	Midwest, Southwest, and far West.		Petroleum		
Debentures, 2⅞'s, 1966		2,205,000		Refunding	2.80
Swift & Co	National		Meat		
Debentures, 2⅝'s, 1972		3,000,000		do	2.60
Trans-Arabian Pipe Line	Near East		Pipe line		
Note, 2.55 percent, 1962		18,000,000		Plant expansion	2.55
Union Oil of California	Far West		Petroleum		
Debentures, 2¾'s, 1970		2,790,000		Refunding	2.69
Note, 2.80 percent, 1972		15,000,000		Working capital	2.80
United Biscuit of America	Midwest		Baking		
Debentures, 2¾'s, 1966		403,000		Refunding andworking capital	2.68
United States Rubber	National		Rubber		
Debentures, 2⅝'s, 1967		2,500,000		Working capital	2.63
Debentures, 2⅝'s, 1976		5,000,000		Working capital and plant additions	2.60
Vincent & Welch	Louisiana		Petroleum		
First collateral note 4's, 1949–53		610,517		Refunding	4.00
Westinghouse Electric	National		Electrical equipment		
Debentures, 2⅝'s, 1971		4,340,000		Plant expansion and working capital.	2.60
Wheeling Steel	West Virginia		Steel		
First mortgage, 3¼'s, 1967		1,425,000		Plant additions	3.12
First mortgage, 3¼'s, 1970		1,661,000		Refunding	3.07
Williams (R. C.)	New York		Wholesale grocers		
Note, 3½'s, 1958		1,700,000		Working capital	3.50
York Corp	Pennsylvania		Air conditioning equipment		
First mortgage, 3¾'s, 1963		1,323,000		Plant additions and working capital	3.66
Youngstown Sheet & Tube	Midwest		Steel		
First mortgage, 2¾'s, 1970		9,000,000		Refunding	2.75

Question D-7.—Corporate investments by classification (as of Sept. 30, 1949)

(*a*) Purchase and lease-back	$39, 550, 912. 11
(*b*) Mortgage bonds	[1] 1, 008, 829, 617. 00
(*c*) Debentures and notes	691, 361, 170. 00
(*d*) Convertible bonds	----------------
(*e*) Preferred stocks	122, 174, 008. 75
(*f*) Common stocks (received in reorganization or merger of railroads)	1, 026, 515. 00

[1] Includes $875,300 general mortgage income convertible bonds.

NOTE.—Bonds at par value; purchase and lease-back at asset value; stocks at cost.

Question D-2 (supplemental data).—Summary of corporate loans according to size (as of Sept. 30, 1949)

Size (in dollars of par value):	*Number of investments* [1]
To and including $125,000	15
Over $125,000 to and including $250,000	19
Over $250,000 to and including $500,000	48
Over $500,000 to and including $1,000,000	51
Over $1,000,000 to and including $3,000,000	152
Over $3,000,000 to and including $5,000,000	77
Over $5,000,000 to and including $10,000,000	49
Over $10,000,000 to and including $15,000,000	16
Over $15,000,000 to and including $20,000,000	10
Over $20,000,000 to and including $24,999,999	1
For $25,000,000	3
For $30,000,000	1
For $31,738,000	1
For $50,000,000	1
Total	444

[1] All railroad, public utility, industrial, and miscellaneous bonds.

Question D (supplemental data).—Bonds purchased Oct. 1, 1948, to Sept. 30, 1949

	Par
United States, State, and municipal:	
June 1949. Henderson (city of) Kentucky Electric Light and Power revenue 3's, 1970–79	$1, 545, 000
October 1948. Maryland (State of) bridge revenue 3.20's, 1972	3, 059, 000
November 1948. Maryland (State of) bridge revenue 3.20's, 1972	422, 000
June 1949. New York City Housing Authority 3's, 1985–90	2, 500, 000
September 1949. New York City Housing Authority 2.80's, 1990–93	2, 500, 000
Total	10, 026, 000
Canadian Dominion:	
September 1949, Dominion of Canada 2¾'s, 1974	21, 758, 000
United States Railroad:	
October 1948. Chicago, Milwaukee, St. Paul & Pacific first 4's, 1994	150, 000
October 1948. Texas & Pacific first 5's, 2000	69, 000
October 1948. Union Pacific debentures 2⅞'s, 1976	772, 000
Total	991, 000
United States public utility:	
December 1948. Alabama Power first 3⅜'s, 1978	1, 000, 000
December 1948. American Telephone and Telegraph 3⅜'s, 1973	5, 000, 000
November 1948. Associated Telephone first 3⅜'s, 1978	1, 000, 000
June 1949. California Water Service first 3¼'s, 1975	1, 940, 000
February 1949. Colorado Power & Light first 3⅛'s, 1979	3. 000, 000
March 1949. Central Maine Power first and general 3's, 1979	2, 000, 000
February–April 1949. Consolidated Edison of New York first and refunding 3's, 1979	13, 000, 000

Question D (supplemental data).—Bonds purchased Oct. 1, 1948, to Sept. 30, 1949—Continued

	Par
United States public utility—Continued	
May 1949. East Tennessee Natural Gas first pipe line 3⅝'s, 1967	$1,200,000
July 1949. Florida Power & Light first 3's, 1979	5,000,000
December 1948. Georgia Power first 3⅜'s, 1978	2,000,000
August 1949. Illinois Power first 2⅞'s, 1979	5,000,000
November 1948. Iowa Public Service first 3¼'s, 1978	500,000
June 1949. Kentucky & West Virginia Power first 3's, 1979	5,000,000
August 1949. Lexington Water first 3's, 1979	500,000
October 1948. Monogahela Power first 3's, 1975	75,000
February 1949. Monongahela Power first 3⅛'s, 1979	2,000,000
September 1949. Ohio Associated Telephone first 3¼'s, 1979	309,000
October 1948. Ohio Edison first 2¾'s, 1975	75,000
April 1949. Ohio Public Service first 3's, 1979	2,000,000
June 1949. Oklahoma Gas & Electric first 3's, 1979	4,945,000
February 1949. Oklahoma Natural Gas debentures 3¼'s, 1969	2,500,000
October 1948. Pacific Gas & Electric first and refunding 3⅛'s, 1982	10,000,000
July 1949. Pacific Gas & Electric first and refunding 3's, 1983	17,489,000
October 1948. Pacific Telephone & Telegraph debentures 3⅛'s, 1983	24,900,000
November 1948. Pacific Telephone and Telegraph debentures 3⅛'s, 1983	100,000
October 1948. Public Service of Colorado first 3⅛'s, 1978	2,500,000
November 1948. Public Service of Colorado first 3⅛'s, 1978	200,000
June 1949. Public Service Electric & Gas first and refunding 2⅞'s, 1979	25,000,000
March 1949. Public Service of Indiana first 3's, 1979	2,000,000
April 1949. Rochester Gas & Electric first 3's, 1979	2,000,000
August 1949. Savannah Electric & Power debentures 3⅞'s, 1969	2,500,000
November 1948. Sioux City Gas & Electric first and collateral 3's, 1978	1,000,000
May 1949. South Pittsburgh Water first 3⅛'s, 1978	700,000
June 1949. Southwestern Gas & Electric first 3's, 1979	2,000,000
March 1949. Southwestern Public Service first 3¼'s, 1979	1,200,000
March 1949. Southwestern Public Service debentures 3½'s, 1974	1,980,000
September 1949. Tampa Electric debentures 3's, 1969	4,000,000
June-July 1949. Tennessee Gas Transmission first pipe line 3's, 1969	20,000,000
November 1948. Texas Eastern Transmission first pipe line, 3⅝'s, 1962	3,600,000
June 1949. Texas Electric Service first 2⅞'s, 1979	1,448,000
December 1948. Texas Gas Transmission first pipe line 3⅝'s, 1968	6,000,000
May 1949. Toledo Edison first 3's, 1979	1,388,000
June 1949. Transcontinental Gas Pipeline first pipe line 3⅝'s, 1968	25,000,000
April 1949. Tucson Gas, Electric Light & Power first 3⅛'s, 1979	3,500,000
October 1948. Utah Power & Light first 2¾'s, 1976	10,000
May 1949. Utah Power & Light first 3's, 1979	2,421,000
June 1949. Virginia Electric & Power first and refunding 2⅞'s, 1979	10,000,000
June 1949. Wichita Water first 3's, 1979	1,450,000
June 1949. Wisconsin Electric Power first 2⅞'s, 1979	1,297,000
October 1948. Wisconsin Power & Light first 3⅛'s, 1978	335,000
September 1949. Wisconsin Public Service first 2⅞'s, 1979	2,000,000
Total	237,062,000
United States industrial and miscellaneous:	
September 1949. Belding Real Estate Co. first 3½'s, 1964	600,000
March 1949. Beneficial Industrial Loans debentures 3¼'s, 1964	5,611,000
January 1949. Bethlehem Steel Consolidated 3's, 1979	9,141,000

Question D (supplemental data).—Bonds purchased Oct. 1, 1948, to Sept. 30, 1949—Continued

	Par
United States industrial and miscellaneous—Continued	
November 1948. Black & Decker 3¼ percent promissory note, 1963	$3,000,000
August 1949. Bullocks 3 percent promissory note, 1964	10,000,000
May 1949, Commercial Investment Trust financial debentures 2⅝'s, 1959	10,000,000
June 1949, Continental Can debentures 3's, 1965	3,500,000
June 1949. 525 Willian Penn Place Corp. first 2½–3½'s, 1980	22,500,000
October 1948. Gerber Products debentures 3¼'s, 1963	1,000,000
July 1949. Great Lakes Pipe Line debentures 3⅛'s, 1969	5,000,000
October 1948. Hammermill Paper debentures 3's, 1965	20,000
October 1948. International Bank debentures 3's, 1972	932,000
March 1949. International Bank (Kingdom of Belgium) 3's, 1969	10,000,000
April 1949. Kuhlman Electric 4¼ percent promissory note, 1959	750,000
May 1949. Libby, McNeill & Libby 3 percent promissory note, 1969	5,000,000
August 1949. Mojud Hosiery 3 percent promissory note, 1964	1,500,000
June 1949. Moore (Benj.) & Co. 3 percent promissory note, 1964	1,500,000
April 1949. National Distillers Products debentures, 3⅛'s, 1974	7,951,000
April 1949. Pennsylvania Salt Manufacturing 3⅛ percent promissory note, 1964	1,500,000
May 1949. Radio Corp. of America 3 percent promissory note, 1974	6,667,000
October 1948. R. J. Reynolds Tobacco Co. debentures 3's, 1973	3,451,000
April 1949. Schenley Industries 3.20 percent promissory note, 1969	8,000,000
October 1948. Shell Caribbean Petroleum 4's, 1968	50,000,000
April 1949. Standard Oil (Indiana) 2.90 percent promissory note, 1979	10,000,000
July 1949. Standard Oil (N. J.) debentures 2¾'s, 1974	31,738,000
August 1949. Sunray Oil debentures 2⅞'s, 1966	9,000
January–July 1949. Trans-Arabian Pipe Line 2.55 percent promissory note, 1962	6,480,000
October 1948. United Biscuit debentures 2¾'s, 1966	61,000
August 1949. Vincent & Welch 4 percent first mortgage and collateral note, 1949–53	635,000
September 1949. Wheeling Steel first 3¼'s, 1967	25,000
September 1949. Wheeling Steel first 3¼'s, 1970	28,000
Total	216,599,000

Question E-1.—Manner of placement of industrial investments as of Sept. 30, 1949

Direct loans (par value):		
By New York Life alone:		
No agent	$35,791,334	
With agent	103,100,000	
		$138,891,334
By New York Life jointly with other companies:		
No agent	56,013,000	
With agent	105,685,000	
		161,698,000
By New York Life jointly with banks or other lending institutions:		
No agent	25,792,517	
With agent	73,500,000	
		99,292,517
Total direct loans (par value)		399,881,851
Preferred stock (cost value):		
By New York Life alone		None
By New York Life jointly with other companies		None
By New York Life jointly with banks or other lending institutions:		
No agent		————
With agent		1,375,402.42

Question B-2.—Securities purchased through underwriters

Bonds, par value	$159, 097, 836. 00
Preferred stock, cost value	77, 892, 951. 01

The CHAIRMAN. Well, your conclusion, Mr. Josephs, is a very excellent place at which to begin questioning you.

Let's take that last summarization:

> Two important byproducts of recent Government policy concern us: (1) maintenance of low interest rates which discourage savings; (2) continued Government deficits through their inflationary effects diminish the purchasing power of savings and destroy the thrift impulse.

Now what would you do if you were a Member of Congress with respect to the management of the public debt—$217,000,000,000?

Mr. JOSEPHS. We would have to begin by balancing the budget.

The CHAIRMAN. All right. I am very glad to begin with that then. How are you going to balance the budget?

Mr. JOSEPHS. Taxes would have to be raised or expenditures reduced.

The CHAIRMAN. And now do you think we can raise taxes as a practical political reality?

Mr. JOSEPHS. They would have to be, or expenses reduced.

The CHAIRMAN. Now you have presented this matter in a theoretical manner. Now I am trying to bring it into the realm of reality.

Of course, it is true you can balance budgets by cutting off expenditures and by raising taxes. The trouble is, may I say, that there are frequently Members of Congress who vote for every reduction of taxes and for every increase of appropriations.

Mr. JOSEPHS. I am familiar with that. I read the papers. This is not an attempt to place the blame but simply to make the point that unless the budget is balanced in good times you will have inflation, and holders of life-insurance policies and Government securities will suffer.

The CHAIRMAN. I think there can be no dispute about that. But over and over again one hears on the radio and reads in the press about the wastefulness of Government expenditures. And I sit upon the Appropriations Committee as well as upon this committee; so, I have had a little experience over the years in the degree to which appropriations are scrutinized by the committee.

I want to point out to you first, before we pursue the matter, that the total cost of the Government of the United States 10 years ago in 1939 was very little more than $10,000,000,000; the total cost for the fiscal year 1950 was in excess of $42,000,000,000.

Now during that period, of course, up to 1939 we heard the same criticism of wasteful Government expenditure that we hear now. Headlines were written upon the assumption that, of course, this is wasteful. Well, war is wasteful. It is the most terribly wasteful enterprise upon which mankind expends itself, not only in money but in blood, too.

But here we have an increase fourfold in a 10-year period. I think most people do not realize that three-fourths of the present Federal budget is war-connected in some respects. We are spending this year over $6,000,000,000 for veterans, veterans' benefits and payments. And I am curious to know whether there are any life-insurance executives who will advise the Congress of the United States to cut that bill for the care of the veterans of World War II below the $6,000,000,000 which we are expending, and whether they have any bill of particulars to us to tell us how it can be done. Shall we stop building veterans' facilities? Shall we stop building hospitals for the veterans? Shall we stop the education of veterans? That was an obligation which Congress assumed after the war because the Government laid its heavy hand upon the youth of the Nation and put them in the Army and in the Navy and deprived them of education.. It was not done because anybody in Congress wanted to do it; it was done because we had to do it in self-defense, and now we are paying the bill. And yet we constantly get expressions from business officers, from financial officers, assuming that these expenditures are a waste.

Now this year we appropriated $15,500,000,000 just for national defense alone; that is, for the Defense Establishment—for the Army, for the Navy, for the United States Air Force. That sum is more than $5,000,000,000 greater than the entire cost of Government 10 years ago.

Now we can cut it, but what life-insurance executive is going to tell us where to cut it and how? Shall we stop building airplanes? A single airplane of the kind that we must have to defend ourselves in the modern arms race costs over a quarter of a million dollars. Who is going to build those airplanes if the Government does not?

And then there is the interest on the national debt. That is over $5,000,000,000. We have got to raise that every year or else we repudiate the bonds. Is any fiscal officer going to tell us to do that? I do not think so.

Then there is the atomic energy. We appropriated last year over a billion and a quarter dollars for that. Who is going to stop it? Will any countinghouse in New York advise us to cut the appropriation of atomic energy?

I am frank to say to you that this is arrant nonsense, from my point of view, the talk about cutting Government expenditures unless we are willing to say, "We shall not defend ourselves. We shall let the international problem catch up with us."

You can read the record in Congress, and while there is talk about items on the bills you never find a minority report saying, "This appropriation must be dropped."

Seventy-six percent of all of our expenditures this year are war-connected. And you correctly pointed out in this document, and I listened to you here, that we have got to decide what we want to do.

Now I am sure that Members of Congress are really no more desirous of wasting the public funds than you gentlemen are desirous of wasting the funds of your policyholders. But I venture to say to you, sir—and I am saying this not to you personally, but I am saying it because I have been brought to the point where I feel I ought to make a public record of the thing—that most of this talk about Government waste is based upon ignorance of the facts and not upon a realization of what your Government has to do.

I think I pointed out in my press conference the other day my own experience with the Atomic Energy Commission. As it happened, the appropriation for the Atomic Energy Commission came before a subcommittee over which I was presiding, and we were disturbed about the expenditures that were being made by the Atomic Energy Commission for construction. And so I personally wrote an amendment which was adopted by the committee, and then by the Senate without dissent, which placed certain restrictions upon the expenditures that could be made by the Atomic Energy Commission for construction. That was adopted in the bill which passed the Congress in August and was signed by the President.

But it was a law of very short duration, because in October, when we discovered that Russia had detonated an atom bomb, then the Joint Committee on Atomic Energy came to the Senate and unanimously recommended the repeal of these restrictions upon expenditures. And Congress felt obligated to sustain the repeal, because nobody in Congress wanted to take the responsibility of saying, "No; we are going to save that money. Let Russia do what she pleases."

So, most of this talk about Government expenditures in my way of thinking is just plain nonsense.

I apologize to you, sir, for having made you the object of this talk. But, when you come to a committee and recommend that we cut expenditures, I must ask you where we are going to cut them. And, of course, I am happy to note that you did recommend that we could also balance the budget by raising taxes. But, personally, I believe that the political realities are such that we cannot do that.

Many of the tax provisions now in the law were adopted for the purpose of financing the war. Some of the excise taxes, for example, were adopted for the purpose of preventing expenditures along certain lines. Well, there is a growing demand, and a demand that you cannot very well argue against, for the repeal of such excise taxes.

Our problem, as far as taxation is concerned, it seems to me, is a problem of finding ways of reforming the tax law so as to produce more business, and because more business, more revenue.

But that brings me now to this first question.

Mr. JOSEPHS. May I just say something, Senator?

The CHAIRMAN. Surely.

Mr. JOSEPHS. I made no statement here concerning the waste of Congress. The only statement I made was, addressing myself seriously to the question of what created instability, that we ought to balance the budget.

The CHAIRMAN. Certainly, I recognize that.

Mr. JOSEPHS. And you asked me the first way to do it, and I suggested raising taxes, and then the other alternative.

The CHAIRMAN. That is right. Then I said to you I was not directing my statement at you but just at these generalities.

Mr. JOSEPHS. Right.

The CHAIRMAN. But now tell me how we are going to change the interest on the national debt. How are we going to let interest rates go up and not have bonds go down? And, if the bonds go down, who is going to buy them? And what are we going to do with the 47,500,000,000 of bonds, United States Savings bonds, which are held by the little fellows? Are we going to let those bonds go down as the bonds of the little fellows went down after World War I to about 80 to 85, so that they passed out of the hands of the small people who invested their small savings to help finance World War I and then were forced to see those bonds pass into the hands of persons who were financially, and institutions which were financially, much stronger?

Mr. JOSEPHS. The debt interest rates are fairly well managed. The result is now that we have set 2½ percent as a top interest rate and the bonds are at a premium. I believe that if the rate was somewhat larger there would still be buyers who would be perhaps more moved toward thrift, and at the same time the holders of the small bonds, unless there was a very serious change, would not cash in. That is a matter of judgment.

The CHAIRMAN. I have heard the criticism of the savings bonds made that they are issued on such terms that the investor who holds a savings bond until maturity earns approximately 3 percent.

Mr. JOSEPHS. That is right.

The CHAIRMAN. Do you think that is a basis of criticism for the bond held by the little fellow?

Mr. JOSEPHS. No.

The CHAIRMAN. I did not think you would.

Well, then, is this more than a general statement that you are concerned about the maintenance of low interest rates which discourage savings? And do they discourage savings?

Mr. JOSEPHS. I think they do. I think that the more a person can earn on his savings, the more reason there is for him to save. That would seem to be true.

The CHAIRMAN. That is true.

Mr. JOSEPHS. And if we set our top rate at 2½ percent for securities, why, then that represents a less attractive figure than 2¾ or 3 percent.

The CHAIRMAN. Then you think as a matter of Government policy we ought to have a maximum rate of 2½ percent on Government bonds? Is that what you are saying?

Mr. JOSEPHS. A maximum?

The CHAIRMAN. Yes.

Mr. JOSEPHS. No. The tendency toward lower and lower interest rates, which has been going on for the last decade or so, is one which will eventually, if assisted in that direction—and we do not know where it will end—discourage savings somewhat further.

In addition to that, it makes life insurance cost somewhat more. So, during a time in which prices are rising, it costs more for a man to protect himself. He may need more dollar protection, and his premiums are higher because the rate of accumulation earned by insurance companies is lowered.

The CHAIRMAN. Would you want the committee to understand that in your belief this declining interest rate is due to Government policy alone?

Mr. JOSEPHS. No; I do not think so. But I would certainly believe that the Government policy, both of the Treasury and Federal Reserve, perhaps assisted the change in rates.

The CHAIRMAN. This morning we had the testimony of Mr. Clarke from the Occidental which shows that in the portfolio of that insurance company common stocks in which they had invested were earning 10.95 percent, whereas their investments in bonds earned only 4.7.

Mr. SCOLL. On the same basis it was 1.5.

The CHAIRMAN. Yes; on the same basis it was 1.5, when figured upon the amount of sales.

Mr. JOSEPHS. We do not think there is any question that common stocks return a larger sum than bonds. I thought he brought that out very clearly.

The CHAIRMAN. What is the answer? If Government policy is bad for interest upon bonds, it has been pretty good for interest upon stocks.

Mr. JOSEPHS. Or perhaps Government policy has made stocks less attractive to purchase. The spread between stock yields and bond yields is wider now than probably it has ever been, certainly in the history of well-kept statistics. I am not sure that is a complete statement. I think it is.

The CHAIRMAN. The records which come to us would indicate that profits on common stocks have been running at peak levels, at levels never before attained. And even the latest figures for 1949 show—well, the latest figures that I saw in the Monthly Letter of the National City Bank of New York showed for some 475 of the largest industrial companies in the United States, the profits for the first 9 months of 1949—or, let's say, the net earnings—were scarcely 6 percent below what they were for the all-time record 9 months, the first 9 months of 1948.

Mr. JOSEPHS. That is right.

The CHAIRMAN. So that profits are running pretty well.

Mr. JOSEPHS. That is right.

The CHAIRMAN. Business is pretty good.

Mr. JOSEPHS. That is right.

The CHAIRMAN. Salaries are pretty good. Everybody is more prosperous and happier than ever before, but there is more crying in the financial circles than ever there was before. Can you explain it?

Mr. JOSEPHS. No; other than we fear what may occur in the future.

The CHAIRMAN. A very wise man once said to me, "The worst things in life never happen."

Mr. JOSEPHS. Well, except this: In a life-insurance company we are dealing with contracts that last for 30, 40, and 50 years ahead of us. And we get in the habit of projecting pretty well into the future what may be the eventual results. And I suppose perhaps it is natural we should look toward the future in considering our investments.

The CHAIRMAN. Then I am sure that every life-insurance executive will agree with me that if we should have a third world war, the outlook will be extremely dark for all life-insurance policies.

Mr. JOSEPHS. I think that is likely, and for all business.

The CHAIRMAN. And for all business. So that it is incumbent upon the Congress in the realities of the situation first to protect the general economy of the people and the peace of the Nation, and then do the best we can to promote prosperity and good business conditions.

Mr. JOSEPHS. I would agree.

The CHAIRMAN. Well, so much for that. I will surrender now to somebody else.

Congressman Herter.

Mr. HERTER. There is great temptation to start an oration at this point, but I think I will hold myself in.

Mr. Josephs, you mentioned in part of your statement that the process by which you shifted your portfolio from Government bonds to corporate financing in the last few years required the Federal Reserve System to absorb a certain number of your bonds. I am speaking of the insurance industry generally. In other words, in that transition period the public or other business concerns did not through the open market take up the bonds and the Federal Reserve had to peg the bond market by absorbing the bonds you got rid of.

Mr. JOSEPHS. That is correct, although we did not sell directly to the Federal Reserve Bank, presumably some of the bonds we sold went there. We tried not to make any investments that themselves did not tend to increase the productive capacity of the country. The real question is whether the monetary inflation created by the Federal Reserve purchasing securities and therefore putting more money into the economy was offset by the deflationary effect of developing expanded facilities that produced more goods to sop up the extra money.

Mr. HERTER. I am wondering whether you have got any figure in mind of a direct relationship between Federal Reserve holdings or acquisitions of bonds and insurance companies shifting their investments away from Government bonds.

Mr. JOSEPHS. No, sir; I haven't. And I think that as far as I know that has not been discussed or thought out. It arises from this fact: That if the Federal Reserve Banks tend to try and stabilize short-term Government securities for the purposes of the banks and banking operations, it is not practical to stop at any one point. If you are going to do any managing at all of the debt, you will have to manage all the way there.

Mr. HERTER. I am told there are some such figures.

Mr. JOSEPHS. You mean the amount they own?

Mr. HERTER. Yes.

Mr. JOSEPHS. I thought you asked as to what might be a proper amount.

Mr. HERTER. No.

Mr. JOSEPHS. The figures are there. I do not remember what they are. There have been some sales, I think, since those figures. The market is up.

Mr. HERTER. Your own continued holding of Government bonds is very much higher than the averages that were given us yesterday for the 17 largest companies.

Mr. JOSEPHS. That is correct.

Mr. HERTER. In other words, in your own investment judgment you felt it was a wise thing to hold on to the amount of Government bonds you have held on to?

Mr. JOSEPHS. That is correct; and at the time when it was believed that our selling created some strain—of course, we are not big enough to strain the Federal Reserve System—but when it did not seem to be in the best public interest, we withheld the sales but recognized the fact that some private industries then did not get the capital they needed at that time.

Mr. HERTER. On that very point, are you as an insurance executive conscious of resistance on the part of buyers to insurance because of a feeling that the dollar is being cheapened through inflationary forces?

Mr. JOSEPHS. It is very difficult to assess the sentiment. We get a good many letters from policyholders: "What are you going to do with us? You should go down and tell Washington not to waste our money." Just the very thing, Senator, you were speaking of, with not much consideration of the problems involved. But it does represent a growing consciousness on their part of the fact that their savings may be less valuable or pay off in dollars less valuable than those in which they were accumulated.

Mr. HERTER. Well, when a prospective purchaser of insurance sees the Government itself increasing pensions of all kinds of former employees, regardless of what happens actuarily to the pension fund, because of the increased cost of living, I should think it would be very discouraging to them because they know you have to operate on an actuarial basis and will never be able to do that.

Mr. JOSEPHS. Of course we collect in dollars and pay off in dollars. But I think the policyholder is becoming more and more conscious of the fact that the dollar will not buy as much.

Mr. HERTER. And I was wondering whether there was any noticeable effect of that state of mind in the purchasing of life insurance.

Mr. JOSEPHS. No, sir; the sales of life insurance, industry-wise, during 1948 were only a little bit below 1947, and I think in 1949 they are substantially the same as they were in 1948.

Mr. HERTER. One other question in that same connection. As the Government is paying out more and more to larger and larger groups in one form of governtmental payment or another—it may be taken from pay-roll taxes and paid out again in the form of some kind of a benefit—do you find that people are getting more conscious of protecting their old age and so are buying more insurance, or is the reverse feeling there that there should be greater dependence upon the Government?

Mr. JOSEPHS. Well, I think there is, perhaps, a little bit of each in that. I think there is a tendency to let the Government take care of it, and yet at the same time there is a greater consciousness of the need of security. Security is something that people are hunting more, much more than they ever did in the history of this country before. So that finds its outlet both in buying insurance and in hoping that the Government in some mysterious way is going to give them something.

So I think it comes in both ways. But there is no question this is a security-conscious population at the present time.

Mr. HERTER. Again from the point of view of your investment policies; if the Government continued to maintain a low interest rate on its long-term securities as well as short-term, and if you find a continuing need by industry for either refunding or principally for development capital of one kind or another, is not your tendency going to be to slough off more and more Government bonds and go more into the private-industry field?

Mr. JOSEPHS. I think it depends on how eager private industry is for capital. That is, if a wider difference develops between what they are ready to pay and what the yield of the Government bonds is, then there will be a tendency to sell Government bonds and invest in private industry because by that method we would get a better rate of return for the policyholder.

Mr. HERTER. May I switch to an entirely different subject?

I notice that in your statement at the very beginning, with respect to the distribution of your investments, you have an item for real estate of, I think, 2.6 percent.

Mr. JOSEPHS. Yes, sir.

Mr. HERTER. Which means wholly owned and operated real estate, does it not?

Mr. JOSEPHS. There are three categories there, I think essentially there are three; our own office building, second is some rental housing, and the third would be lease-backs, which is a new venture, as was brought out this morning.

Mr. HERTER. You have gone into housing developments quite near the city here, have you not? It seems I recall seeing one in Virginia.

Mr. JOSEPHS. No; that is not ours. We have one just outside of Princeton. We have one in Fresh Meadows, outside of New York, and we have a big apartment-house development on Manhattan Island, and then another commitment in Chicago.

Mr. HERTER. What does that run?

Mr. JOSEPHS. About $60,000,000 so far in rental housing, although with commitments for a little bit more in that regard, 20 million more, and then in our lease-backs it runs about 35 to 40 million.

Mr. HERTER. So in that type of development you do have to take a certain amount of management responsibility, do you not?

Mr. JOSEPHS. We have to take a management responsibility not in the lease-backs but in the rental housing.

Mr. HERTER. When you made up your minds to go into that type of housing, did you do it because it looked like a superior investment or because you felt at that time it was one of the great social needs to which you could make a contribution?

Mr. JOSEPHS. Three reasons: one, diversification; second, we thought we could get an adequate return; and third, there was a very pressing social need. We thought perhaps we could build better housing ourselves than some that had been done.

Mr. HERTER. With your experience in housing with the high construction costs, have you found it to be a reasonably good investment?

Mr. JOSEPHS. Yes; we have not had a long enough test, but our project in Princeton, N. J., has been completed for 2½ years. That gives us a satisfactory return, and it is beginning to amortize some of the high costs. The one in Fresh Meadows has just been completed and fully rented, and I think there is no doubt that it will turn out to be all right.

Mr. HERTER. Thank you.

Mr. JOSEPHS. There is nothing so far to change our original idea.

The CHAIRMAN. Congressman Buchanan?

Mr. BUCHANAN. You operate under the New York laws relative to ownership of real estate.

Mr. JOSEPHS. Yes.

Mr. BUCHANAN. What is the New York statute?

Mr. JOSEPHS. We are allowed to go into rental housing to the extent of 10 percent of our assets, and we are allowed to enter these so-called lease-backs to the extent of 3 percent of our assets.

Mr. BUCHANAN. And on mortgage loans?

Mr. JOSEPHS. Mortgage loans, 40 percent of our assets.

Mr. BUCHANAN. There has been quite an increase in the last 4 years in total number of mortgage loans by Government and private investment institutions. Are you unduly alarmed at the tremendous increase so far as liberal Government policies are concerned?

Mr. JOSEPHS. Not as far as the FHA policy has gone, not a bit. That is, the mortgage on individual houses up to 80 or 90 percent, which go through the FHA do not bother us. Those individual mortgages, where you have monthly amortization are safe, and the FHA has stimulated the building and private financing where it used to be very expensive.

Mr. BUCHANAN. How about the veterans?

Mr. JOSEPHS. The same thing, but once you get to a hundred percent lending, there are very few brakes. People rush in when they perhaps are not quite ready to buy, and have not really understood what the costs are. When they have no money to put up at all, there are inherent dangers.

Mr. BUCHANAN. But you are not unduly alarmed?

Mr. JOSEPHS. No, sir.

Mr. BUCHANAN. We are on the House Banking Committee and I believe on the Senate Banking Committee. It deals with the subject as to how far and how fast we are moving toward liberalization of these terms. I am glad to hear you say you are not concerned.

Mr. JOSEPHS. Not so far. There are some aspects of Government housing that do concern us. The question of where various governmental bodies may go, with tax exemptions, and compete with private industry and private building. We think that may be dangerous—Government housing.

Mr. BUCHANAN. The tremendous growth of public housing?

Mr. JOSEPHS. Yes.

Mr. BUCHANAN. That is all.

The CHAIRMAN. May I ask you to turn to page 7 of your paper? The last paragraph, you state:

> It is our view that there has not been any shortage of outlets for savings channeled through life insurance companies.

That is a very interesting statement, and I would like to have you amplify it a little bit. I am thinking in terms of small business and local business. The statistical material which you have submitted seems, in general, to be in harmony with that which has already been submitted on behalf of the 17 largest companies and by the Metropolitan yesterday—namely, that so far as these industrial loans are concerned, the bulk of them goes into those in the higher brackets. So I am asking you to amplify that picture just a little bit for us, if you will.

Mr. JOSEPHS. I think as far as private investment in general goes, the fact that we sold Government bonds in order to make private investments probably is all that needs to be said on that.

I imagine that your questions are directed more toward the small investments rather than private investments as a whole.

The CHAIRMAN. Well, the statement as it is written would imply that there have been many rejections, that you get many more applications than you can fill.

Mr. JOSEPHS. No question about that—more than we care to fill.

The CHAIRMAN. Are we to understand that those applications which you do reject are rejected because of inherent difficulties, lack of security, poor management, or the like?

Mr. JOSEPHS. We do not think there is enough protection for the policyholders' money.

The CHAIRMAN. Then when you say that there is no shortage of outlets, that would indicate that you can pick and choose among pretty good outlets, does it not?

Mr. JOSEPHS. Yes. It means that there were enough outlets so that we sold Government bonds in order to put the money out, and where we have found a satisfactory private investment that differs in the rate from the Government rate sufficiently to justify the increased risk of other than Government securities, we have sold Government bonds and invested the money in a private direction.

The CHAIRMAN. But the testimony of the Small Business Advisory Committee on Tuesday afternoon was to the effect that the groups represented by that committee do not have access to sufficient money even for loans. What is your experience on that?

Mr. JOSEPHS. Our experience is that we have 140 loan correspondents throughout the country. They send in applications to us for loans. We are eager to put money out. We get a lot better rate than this low Government rate I have been referring to, and we are eager to put our money out. But there are many applications that are not, from our point of view, satisfactory.

The CHAIRMAN. Now, here is your response to question C, which shows investments requested by group classifications. In the first classification, manufacturing, you have $407,950,000 invested. The summary of your corporate loans would indicate that below $125,000 in amount for the classification you have only 15 investments, and that is 15 out of a total of 444, which would seem to be the same pattern that has been revealed in these other statistics.

Mr. JOSEPHS. There is, however, something I think should be added to that. When you have relatively small companies, and you want to be assured—when they want capital for a long period of time—you have to have certain assurances of stability and very frequently that comes through real estate, and the result is that we have made a good many commercial loans that come in under our mortgage category that are really for small enterprises.

Then again we do not know the extent to which the policy loans and home mortgages, for example, may have been made for business purposes.

The CHAIRMAN. Your mortgages on the commercial real estate show up at $105,079,000, but apparently that was not broken down.

Mr. JOSEPHS. No, but in my statement, Senator, we referred to the fact that we had made 1,278 mortgage loans on commercial properties.

The CHAIRMAN. How many?

Mr. JOSEPHS. One thousand two hundred and seventy-eight mortgage loans on commercial properties.

The CHAIRMAN. Yes; an average amount of $82,222.

Mr. JOSEPHS. That is correct.

The CHAIRMAN. So that average again would indicate that the—well, it might indicate that there were some pretty small ones in there.

Mr. JOSEPHS. We have a list of quite a number of small ones.

The CHAIRMAN. What is your smallest?

Mr. JOSEPHS. The smallest, I think, on this is—I see a 45 here, a 30, a 25—they were for stores. I think $25,000 is the lowest we have here.

The CHAIRMAN. That is running pretty low for New York Life.

Mr. JOSEPHS. It is for people who have the need for only a very small sum of money, who have a very small operation, and have got to give bricks and mortar as security.

The CHAIRMAN. Is your organization such that you can appraise these smaller loans in distant parts of the country and service them to your own satisfaction, too?

Mr. JOSEPHS. We do that through our mortgage correspondents and then we have loaning offices in different parts of the country.

The CHAIRMAN. How much independent discretion do the correspondents have?

Mr. JOSEPHS. For residential, it runs, I think, up to $10,000. By law all investments of the New York insurance companies must be made by the finance committee, so that the delegation down the line is only a tentative one, and it becomes a matter of custom. But let me say that customarily we have no difficulty in allowing the local people to give satisfaction.

The CHAIRMAN. That brings me to a question about the New York State law. You made some comment about the regulations being in too great detail with respect to preferred stocks. Are the regulations in too great detail in any other respects?

Mr. JOSEPHS. I do not think so. There are one or two regulations in respect to earnings, which occasionally have prevented a prudent investment, because it did not meet with the requirements; but I think whenever you set any detailed regulation, there is bound to be a case which seems absurd.

The CHAIRMAN. Does your company have any opinion with respect to this common-stock business?

Mr. JOSEPHS. Yes; we have an opinion. First, we see no reason to object to the removal of the restriction in New York State. We would ourselves immediately study the matter. Although we discuss it as an academic question now, we would set to work immediately to discuss it as an actual practical question.

The CHAIRMAN. Would you recommend it?

Mr. JOSEPHS. Recommend——

The CHAIRMAN. The removal of that restriction.

Mr. JOSEPHS. Yes; we would recommend the removal.

The CHAIRMAN. You would like to invest in common stocks?

Mr. JOSEPHS. We would like to discuss the matter further. There are a lot of questions involved, not only the simple question—may I say I am on a number of finance committees in other directions in which we invest quite liberally in common stocks—but there are a good many questions involved as to how policyholders would take it. It has been a tradition certainly in the New York insurance companies that they not buy them.

The CHAIRMAN. Do you not think, as you intimated here, that might lead to control or attempts to control the management of the corporations in which you purchased voting power?

Mr. JOSEPHS. I do not think it would lead to control or the attempt to control, but I think it might lead to the accusations that we were attempting to control, and that would be a very serious matter.

The question was brought out this morning as to what control is obtained if you bought stock with voting rights. Well, you buy management—I think you stated that this morning—you really buy management. That is true, and you cannot very well waive a right that is inherent in a common stock. Those are the types of questions that we think need very careful study.

The CHAIRMAN. It has often been charged that insurance companies and other institutional lenders, even through the purchase of bonds, have secured domination over policy and management.

Mr. JOSEPHS. That is right, sir. I am familiar with that.

The CHAIRMAN. Do you care to make any comment about that?

Mr. JOSEPHS. Yes. If that question is raised when we are inert bondholders, it is going to be raised much more seriously if we are common stockholders.

The CHAIRMAN. Is there any basis for it in the case of the inert bondholder?

Mr. JOSEPHS. None at all, sir; none at all; and I think there would not be in the case of common stockholders. That would not relieve us from the fact that we might be accused of it.

Mr. HERTER. May I interject there? In the case of the $50,000,000 loan you speak of, I think, in here as the maximum that you made, you certainly must satisfy yourself pretty much as to the management of that particular outfit before you make the loan.

Mr. JOSEPHS. Yes.

Mr. HERTER. Once the loan is made, there is nothing you can do about it.

Mr. JOSEPHS. That is correct, and unless the terms of the indenture are violated, there is nothing we can do.

Mr. HERTER. I have another question on the common stock end of this. In Massachusetts, for instance, a limited amount of common stock is allowed. Massachusetts companies qualified to do business in the State of New York in filing their statements, I think they make the statement to the effect that they are substantially complying with the laws of the State of New York.

Mr. JOSEPHS. Yes.

Mr. HERTER. And it is purely a discretionary matter with the commissioners, whether they will or not let them in. I do not know how the commissioner uses his discretion, as to whether it is 3 percent of assets in common stock—admitted assets, I believe is the term. Do you find that in any way an embarrassment to you in a comparative field, that companies who can invest in common stocks are competing with you?

Mr. JOSEPHS. Not at all, and in suggesting that we would advocate the change of the New York law, it was for the purpose of bringing into sharp discussion the possibility of investing in common stocks with each individual company.

The CHAIRMAN. Did you participate in that $250,000,000 transaction with Shell Caribbean that was mentioned yesterday?

Mr. JOSEPHS. Yes, sir.

The CHAIRMAN. How much of that did you get?

Mr. JOSEPHS. Fifty million.

The CHAIRMAN. Are there any other foreign investments of that kind?

Mr. JOSEPHS. That is a domestic company. It is incorporated in this country.

The CHAIRMAN. But it is doing business foreign.

Mr. JOSEPHS. And the collateral, the most important part of the collateral, as far as we are concerned, is in the Shell Co. in this country.

The CHAIRMAN. My question was with respect to your general knowledge of insurance investments. Are there many of that character or of a similar character in such operations?

Mr. JOSEPHS. Well, there was one pipe line in Arabia guaranteed by a number of companies.

The CHAIRMAN. That is right. I remember that.

Mr. JOSEPHS. I do not remember any large ones. Oh, yes; the International Bank would be another one.

The CHAIRMAN. Well, that would fall, I think, into a different category.

Mr. JOSEPHS. Then I do not remember any outstanding ones at the moment.

The CHAIRMAN. Would you say that on the whole most of the life insurance funds are invested in domestic enterprises, except for these Government bonds, Canadian bonds, the International Bank, et cetera?

Mr. JOSEPHS. That is right, and they must be by law.

Mr. HERTER. In the case of the International Bank you always have recourse to the American Government guaranty.

Mr. JOSEPHS. Not to a guaranty, but we have their statements, and we see the amount of American subscriptions that has not yet been paid in.

Mr. HERTER. Up to the 3½ billion?

Mr. JOSEPHS. That is correct.

Mr. HERTER. They are nowhere near that figure?

Mr. JOSEPHS. That is right. We get their statement annually.

The CHAIRMAN. On this same page, page 7, in the paragraph before the one we were just discussing, you say:

> If new accumulations of money by insurance companies are insufficient to meet the legitimate demands for private capital, Government bonds will be sold to meet these needs.

Now, on the whole is it your opinion that accumulations are sufficient for that purpose now?

Mr. JOSEPHS. No; and as a matter of fact, that should have read "If new accumulations of money by insurance companies 'and others,' " because insurance companies do not bear the whole load. I think at the moment it would seem to us that the demands for private enterprise, particularly while building is going on, home residential building, the accumulations of 4 or 4½ billion a year will not be sufficient by any means.

The CHAIRMAN. Then in your opinion the economy at present is expanding at a rate which requires more capital than it is getting?

Mr. JOSEPHS. That is correct.

The CHAIRMAN. Have you any suggestions——

Mr. HERTER. More capital than it is getting from the insurance companies?

Mr. JOSEPHS. That is correct.

The CHAIRMAN. And others?

Mr. JOSEPHS. And other savings institutions.

The CHAIRMAN. That means, then, I take it, that in your opinion there is an opening for equity capital there if the way can be found to furnish it; is that right?

Mr. JOSEPHS. I think so; yes.

The CHAIRMAN. Have you any suggestions to the committee as to what should be done to promote the investment of equity capital?

Mr. JOSEPHS. I have some reluctance to suggest that the tax problem is one which might deter people from investing in equities, both the double taxation involved, and certain other factors.

The CHAIRMAN. Oh, good, bring up this double taxation and tell us about that.

Mr. JOSEPHS. I am afraid I used a shorthand phrase there.

The CHAIRMAN. That is all right.

Mr. JOSEPHS. Simply that the corporation will have a 38 percent tax and then the owner of that corporation in part also pays a tax on the 62 percent which is left to him.

The CHAIRMAN. Are you an advocate of the theory that the corporate tax should be repealed and the individual should bear the whole tax?

Mr. JOSEPHS. No, sir.

The CHAIRMAN. That suggestion has been made by a very respectable authority, you know, outside of Government.

Mr. HERTER. It has also been suggested that some credit be given for the taxes paid at the source.

Mr. JOSEPHS. Yes, and there are various devices. In other words, if it is thought desirable to make common stocks more attractive, then presumably some change in the tax law might be made for that purpose. That is all. Yet at the same time the Government must have the revenue.

The CHAIRMAN. Then, as Congressman Herter suggests, would it be your thought that the concessions should be merely that the stockholder should be given credit for the tax paid at the source—that is, by the corporation? Do you think anything should be done to encourage the distribution of these earnings?

Mr. JOSEPHS. I do not think so, because such a very large percentage of the money used for expansion in our economy comes from withheld earnings, sums that are not paid out in dividends, and are used for expansion purposes. You kill the goose that lays the golden eggs if you interfere with this.

The CHAIRMAN. Of course, the small-business men tells us the little enterprise cannot very well finance itself out of retained earnings and, of course, that there should be tax alterations to encourage the plowing back of income. Then you have no additional suggestion to make on that?

Mr. JOSEPHS. No, sir.

The CHAIRMAN. It is not your purpose, then, to suggest either that the corporation should be completely excused from paying taxes or that the whole tax should be paid by the stockholder on his dividends?

Mr. JOSEPHS. No, sir.

The CHAIRMAN. Mr. Scoll, do you have some questions?

Mr. SCOLL. I would like to go back to the Government bond rate for a moment. Would you like to state, Mr. Josephs, at what point in the business cycle do you think the Government interest rate ought to increase? When the cycle is in a deflationary trend, or on the inflationary trend?

Mr. JOSEPH. I am afraid I am not very competent to do that. I am not an economist.

Mr. Scoll. Well, that would certainly have some bearing on the question of whether or not a yield on Government bonds should be increased; would it not?

Mr. Josephs. Well, certainly, if during an inflationary trend increased interest rates tend to slow down inflation, I am perfectly ready to say that.

Mr. Scoll. Would you do it now?

Mr. Joseph. I think I would like to consider that.

Mr. Scoll. You mean you do not want to give an answer?

Mr. Josephs. That is right.

Mr. Scoll. Now, on the top of page 11 you said:

> Any attempt to substitute detailed mathematical standards or statistical hurdles for ripe judgment would do more harm than good.

By that statement do you mean to apply it only to governmental regulations, or did you mean there some other form of detailed mathematical standards that might be applied to the value of securities?

I have in mind the ratings, for example, of Moody's, et cetera. Did you have those in mind?

Mr. Josephs. I had in mind that earnings should be so many times the interest charges or there should be no loss in the last 5 years or various other standards that have occasionally been put in in different State laws.

Mr. Scoll. Do you mean to give the impression, then, that you do not make your investment judgments of rated securities solely on the basis of the ratings?

Mr. Josephs. No. We make our investments on our own investigation and our own judgment, and we are ready to stand or fall on them. Rating services are a convenience to those who may not have a statistical force.

Mr. Scoll. Do you find your judgment sometimes different from that of the rating agency?

Mr. Josephs. It could be. It has been.

Mr. Scoll. In which way?

Mr. Josephs. I do not think it is very often. We do not rate a security in our own minds. It is either acceptable to us or it is not.

Mr. Scoll. Regardless of the rating?

Mr. Josephs. That is right, but we have to recognize the fact that if we buy it at below the acceptable rating, then it is not amortizable. It carries with it a market hazard.

Mr. Scoll. What do you think of the rating system generally?

Mr. Josephs. It is a rough approximation of values. I do not think we would be ready to suggest it be thrown out until we thought of something better.

Mr. Scoll. You could get along without it?

Mr. Josephs. Very well.

Mr. Scoll. Now, with respect to the diminution of the value of your insurance contracts as a result of inflation, have your basic premium rates gone up in relation to that problem?

Mr. Josephs. Yes.

Mr. Scoll. You have raised your basic premium rates?

Mr. Josephs. Yes.

Mr. Scoll. For the same dollar contracts?

Mr. Josephs. That is correct.

Mr. SCOLL. Now, what influenced you to raise those rates?

Mr. JOSEPHS. Two matters: One, the smaller rate of accumulation on the reserves, and the other one was the increased cost of doing business.

Mr. SCOLL. The smaller accumulation of reserves?

Mr. JOSEPHS. There is an offsetting factor in regard to that. We made a more liberal assumption in regard to mortality under the new CSO tables. They offset each other.

Mr. SCOLL. That offset resulted only perhaps in a lesser increase, you mean?

Mr. JOSEPHS. That is correct. In other words, we had a countervailing factor there.

Mr. SCOLL. Going back to the question of the lower increment, I believe you stated it is a lower increment on reserves, which is one of the reasons for raising the rate.

Mr. JOSEPHS. That is correct.

Mr. SCOLL. What was that lower increment the result of?

Mr. JOSEPHS. Lower earnings on those reserves. We invested at a lower rate of interest.

Mr. SCOLL. Now, I noticed that in each classification of investment in your statement the percentage of the total portfolio under each allowable statutory classification is somewhat lower than the statutory limit. That is true of all those classifications; is it not? You are lower than the statutory limit.

Mr. JOSEPHS. Yes, the statutory limit applies to mortgages. There is no statutory limit on governments or on bonds. There is, on mortgages, on preferred stocks, and on real estate. As a matter of fact, all three of those are increasing relative to our assets.

Mr. SCOLL. So, to some extent it is possible, is it not, to find forms of investment that will bring higher yields than governments and the corporate yields that are influenced by governments? I have in mind, for example, the yield on sale and lease-back arrangements, the yield on direct housing investments.

Now, to some extent those investments tend to offset the diminution of your reserve increment, do they not?

Mr. JOSEPHS. No; because the life-insurance business is based on investments, private investments. Twenty years ago, 30 years ago, very few Government bonds were held by insurance companies, and the price on securities now, senior securities, the securities where the risk element is not present or very little present, is relative to the price of Government bonds.

Mr. SCOLL. I want to pursue another aspect of that same problem. Generally speaking, you estimate your maturities on your investments in some way in relation to the maturities of your contracts, do you not?

Mr. JOSEPHS. No, because you have so many contracts sold each year of various varieties that there is a steady stream of them maturing every year, so that you do not offset that.

Mr. SCOLL. There is no relationship between the maturities on your investments and maturities on your contracts?

Mr. JOSEPHS. No.

Mr. SCOLL. Mr. Woodward yesterday had one table that showed the amount of insurance payments on contracts relatively stable over a period of quite a number of years. He said that was due to the fact that the entire amount of contract accruals was not paid out because the beneficiaries preferred to take annuity payments and to spread the payments out over a considerable period of years.

Mr. JOSEPHS. That is correct.

Mr. SCOLL. Now, does that not tend to offset the diminution of your reserve increments you were speaking about before?

Mr. JOSEPHS. No, because each contract that is made rests on its own feet. The reserves are accumulated at the contractual rate. A couple of decades ago we guaranteed 3 percent accrual rate on our contracts. Now it is down to 2 percent.

Mr. SCOLL. So you are still paying out on contracts that you contracted for at 3 percent?

Mr. JOSEPHS. Yes.

Mr. SCOLL. Many on an annuity basis?

Mr. JOSEPHS. Some are on an annuity basis and some on life insurance contracts where the accrual on benefits left with the company is 3 percent.

Mr. SCOLL. That is one of the factors added into the decision, the requirement for increasing the rates?

Mr. JOSEPHS. That is correct.

The CHAIRMAN. May I interrupt, Mr. Scoll?

Looking over this list of industrial and miscellaneous, I saw a couple of items that attracted my attention. For example, here is Sunray Oil debentures, $9,000, and on the same page Hammermill Paper debentures, three's, 1965, $20,000. The last one on the list, Wheeling Steel, $28,000.

That suggests to my mind the question: In the tabulation of the amounts of the loans, are not some of these small figures which you have only part of a large issue that some company may have given out?

Mr. JOSEPHS. Some of them are.

The CHAIRMAN. These are participations?

Mr. JOSEPHS. These are participations.

The CHAIRMAN. Will your division, therefore, of your investments by size category correctly reflect the actual size of the borrower?

Mr. JOSEPHS. Of the corporation? No; they will not.

The CHAIRMAN. Mr. Scoll thinks they have been distinguished elsewhere.

Mr. PAYNTER. Might I explain that? Those were open market purchases additional to holdings we already had, and these particular purchases listed here would have been added to our already acquired holdings.

The CHAIRMAN. But a $20,000 item for Sunray could not be statististically represented as a small loan, because it is part of a large loan, although it is a small loan for you.

Mr. PAYNTER. But in this case it was added to the Sunray bonds we had bought before.

The CHAIRMAN. Yes.

Mr. SCOLL. The Senator's question was in the early part of your statement you have there the average size of corporate borrowings of around 82,000. Did these purchases of open market securities enter into that?

Mr. JOSEPHS. Not a bit. That I was going on to say.

Mr. SCOLL. One final question or two on this question, the diminution of the dollar value of the insurance contracts. Has your company considered any other means of providing your policyholders, new or old, with some form of dollar parity in this long inflationary cycle we seem to be in?

Mr. JOSEPHS. We know of no way to do that, no practical way.

Mr. SCOLL. You regard that as the responsibility of the Government and the economy as a whole?

Mr. JOSEPHS. That is right. I do not think there is any legal escape from the effects of inflation by any large group of people. There may be individuals who could buy gold or find some personal hedge, but it would be only a very miniscule part of the population.

Mr. SCOLL. In response to the chairman's question in connection with your recommendations, you suggested increasing taxes. I do not know whether you got a chance to express yourself as fully on that as you wanted to. Did you have any particular form of taxes in mind?

Mr. JOSEPHS. No.

Mr. SCOLL. Like increasing the corporate tax, for example?

Mr. JOSEPHS. No.

Mr. SCOLL. Or any other?

Mr. JOSEPHS. No; I do not think I am prepared to state that.

The CHAIRMAN. What is the experience of your company with the sale and lease-backs?

Mr. JOSEPHS. So far, the law was passed in New York State in 1945, and it has been entirely satisfactory to date. We would hope to go further.

The CHAIRMAN. How much do you have in that?

Mr. JOSEPHS. I think it is 40,000,000.

The CHAIRMAN. What are you earning on that?

Mr. JOSEPHS. We account at 3¼ percent, approximately. We write down some of the principal that is invested annually because some of our sale and lease-backs are in the form of factories which may not have a terminal value at the end of the lease; so that we write off each year a certain sum and credit ourselves with about 3¼ percent.

The CHAIRMAN. In your transactions are you also, like the witness this morning, in the position of agreeing with the return by way of rent which the seller fixes?

Mr. JOSEPHS. It is a negotiation in which if the rate is not satisfactory to us, we do not buy. That is, the terms of the net lease. It is negotiated at that time.

The CHAIRMAN. I think it would be of great interest to know the character of company which engages in that sort of transaction, as to size.

Mr. JOSEPHS. Well, they vary. There are different sizes. The ones we have are relatively large. There may be stores worth 50 or 75 or a hundred thousand dollars, I think the largest might be a $9,000,000 or $11,000,000 building.

The CHAIRMAN. Is it your experience that many collegiate endowment funds are so invested?

Mr. JOSEPHS. There are some. There are other problems involved there, and if I might, I would like to say something about the tax question, which I think was not spoken of this morning. There was the statement that the companies entering these transactions and selling their property then were able to deduct the rental from their income tax, and presumably there was a tax saving.

They, of course, would lose at the same time, as a partially offsetting item, the right to have a depreciation on that real estate, and the difference between the two might possibly be a small tax advantage, but we have never seen any company come to us in which that had any material bearing on their decision.

The CHAIRMAN. What in your judgment are the economic factors which have promoted that sort of deal? It is a very recent development.

Mr. JOSEPHS. It is the cheapest way for them to get additional capital. Where you have a merchandizing company, for example, that has a great expansion in volume and in unit price, so that for two reasons they need a great deal more working capital, they can take it out of the bricks and mortar and use it in the inventory. That is one of the factors. There are others.

The CHAIRMAN. Have insurance companies, so far as you know, tended to go into the ownership of any industrial enterprises?

Mr. JOSEPHS. We do not. We would not and I do not know of many cases. I am sure there are some.

The CHAIRMAN. I have heard of some endowment funds that have gone into the purchase of department stores.

Mr. JOSEPHS. Yes; I think there may be cases. There are different factors involved.

The CHAIRMAN. Surely; I know that, but insurance companies have not done that, so far as you know?

Mr. JOSEPHS. I do not know.

The CHAIRMAN. Are there any other questions?

Mr. KREPS. I would like to ask one or two.

Mr. Josephs, on page 4 at the end of the first paragraph, you say:

> Over a future period of, say, 5 years, the volume of new money to be invested by all the companies should be about 4½ billion dollars a year. This growth can be compared with the aggregate national investment of new private capital, including funds for housing, which was estimated for 1948 to be 10 times this figure.

I take it you mean gross private domestic investment rather than new private capital; is that right?

Mr. JOSEPHS. That is quite right.

Mr. KREPS. That, of course, includes a great deal of capital obtained from internal sources, does it not?

Mr. JOSEPHS. Most of it is from internal sources.

Mr. KREPS. The amount for mortgage loans is about $6,000,000,000 even in 1948?

Mr. JOSEPHS. It would be at least that.

Mr. KREPS. That would be the one source you would be most interested in?

Mr. JOSEPHS. It is one of them, but then the public utility companies, industrial companies also.

Mr. KREPS. Those are also corporate loans, are they not?

Mr. JOSEPHS. They have been heavy borrowers.

Mr. KREPS. All corporate mortgage loans, about $6,000,000,000?

Mr. JOSEPHS. Six billion, as well as private residential.

Mr. Kreps. That includes everything?

Mr. Josephs. Yes.

Mr. Kreps. I was sure of that. Of course, that $45,000,000,000 figure is rather high, if not unduly high.

Mr. Josephs. Yes. It represents a more constant percentage of the national product.

Mr. Kreps. At the bottom of page 13 of your statement you say:

> Two important byproducts of recent Government policy concern us: (1) Maintenance of low interest rates which discourage savings; (2) continued Government deficits through their inflationary effects diminish the purchasing power of savings and destroy the thrift impulse.

Do you mean that we are at the point at which these effects are likely to take place or do you mean those statements as a summary of the experience of the last 20 years?

Mr. Josephs. I meant it as perhaps a caution. Habits of people move very slowly. They often have changed before we recognize it. It was simply the statement that eventually, if continued, that would probably happen.

Mr. Kreps. My reason for asking the question is that on page 5 of your testimony you give a table showing the increase in purchases of life insurance. I have set next to such life insurance sales figures the changes in interest rate. As you know offhand, the interest rate has steadily declined from 1932; it went up from 5.1 in 1930 to 6.9 in 1932, and then steadily declined to 3.1. This is the bond interest rate, which you quite rightly say is affected by the rate on Government bonds. The comparison with your figures is as follows:

Year	Percent increase in sales of life insurance	Bond interest rate	Gross private savings	Personal savings
		Percent	*(billions)*	*(billions)*
1930	6	5.1	11.2	3.0
1931	5	5.8	8.4	2.0
1932	1	6.9	2.8	−1.2
1933	1	5.9	2.8	−1.0
1934	6	5.0	5.6	−.072
1935	8	4.5	7.9	1.9
1936	9	3.9	11.1	3.8
1937	6	3.9	10.8	4.1
1938	7	4.2	8.9	1.1
1939	7	3.8	12.7	2.7
1948	------------	3.1	38.5	12.2

Now, in that period life insurance has not gone down, life-insurance sales have not suffered, though the interest rate has nearly been cut in half.

Mr. Josephs. That is correct. This is the growth of the life-insurance companies, but is not the index of the new sales made annually.

Mr. Kreps. This is the growth of the assets?

Mr. Josephs. Admitted.

Mr. Kreps. It represents, then, in effect savings?

Mr. Josephs. But there may be other factors that would come in. For instance, this was a decade of growing interest in security, in buying security, which would be a countervailing influence.

Mr. KREPS. It is quite interesting that gross private savings have also gone up to unprecedented heights in that same period.

Mr. JOSEPHS. That is right.

Mr. KREPS. Is it not true also that the greater the Government deficit the greater the growth of private savings?

The CHAIRMAN. You are not arguing that we ought to have a deficit in order to promote savings, are you?

Mr. KREPS. No; but I am saying a Government bond is, of course, a liability of the Government. It is also savings to the individual.

Mr. JOSEPHS. That is correct.

Mr. KREPS. And, therefore, in all the tables you find that the savings of individuals have likewise risen to an all-time high with the increase in the Government debt.

Mr. JOSEPHS. That is correct.

Mr. KREPS. Have you found any influence, so far as inflation is concerned, on your policyholders of this nature—that because prices have gone up, they have taken out more insurance in order to afford themselves the same protection that they had before with reduced face value of their policies?

Mr. JOSEPHS. There has been a steady rise in, for instance, the average size of our policy, the average amount that is held per family throughout the country. That has been constantly rising.

Mr. HERTER. May I interject one thing? I think yesterday there was submitted a very interesting table showing that the rise can be very much minimized if you translate it into terms of purchasing power, going back to dollars, whether they were 1935 or 1939 dollars, that the increase has been dollarwise but not in purchasing power.

Mr. JOSEPHS. As a matter of fact, I think the percentage of the annual income devoted to insurance-company premiums has actually declined.

Mr. KREPS. That may well be.

Mr. JOSEPHS. Of the family income or the national average individual income.

Mr. KREPS. Since 1932 the percentage of personal savings has not declined.

Mr. JOSEPHS. No.

Mr. KREPS. And did not decline during the period of inflation.

Mr. JOSEPHS. No; I think not.

Mr. KREPS. Inflation tends to increase savings.

Mr. JOSEPHS. It may; yes. I think it does.

Mr. KREPS. Particularly those with flexible incomes.

Mr. JOSEPHS. But perhaps not what the savings can buy.

Mr. KREPS. That will vary. That is quite right. Then these two statements are really an expression of your fears for the future; is that right?

Mr. JOSEPHS. That is right.

Mr. KREPS. Rather than any feeling that at the present time the rate of interest that presently exists either has discouraged savings or is discouraging savings or has discouraged life insurance or is discouraging life insurance?

Mr. JOSEPHS. That is correct.

Mr. KREPS. That is all, Mr. Chairman.

The CHAIRMAN. Mr. Josephs, we are very much indebted to you for a very lucid statement. It has been a very interesting afternoon.

Your old college mate, Congressman Herter, agrees with me that it turned out to be most interesting.

The program for tomorrow, beginning at 10 o'clock, will be the presentation by Mr. Oliver M. Whipple, financial vice president of the Mutual Life Insurance Co., of New York, and Mr. Robert Patrick, of Bankers Life Co.

The committee will stand in recess until tomorrow morning at 10 o'clock.

(Whereupon, at 4:45 p. m., the subcommittee adjourned, to reconvene at 10 a. m., Friday, December 9, 1949.)

VOLUME AND STABILITY OF PRIVATE INVESTMENT

FRIDAY, DECEMBER 9, 1949

Congress of the United States,
Joint Committee on the Economic Report,
Subcommittee on Investment,
Washington, D. C.

The subcommittee met, pursuant to adjournment, at 10 a. m., in the caucus room, Senate Office Building, Senator Joseph C. O'Mahoney (chairman) presiding.

Present: Senator O'Mahoney (chairman) and Representative Buchanan.

Also present: David Scoll, special counsel to the committee and Theodore J. Kreps, director of staff.

The Chairman. The committee will come to order.

Let me say at the outset that the committee is very grateful to spokesmen for the insurance industry who have testified. We appreciate the information which has been supplied to us, and if at all possible, we would like to give you all the afternoon off as well as Saturday. So we will endeavor to finish with the two witnesses this morning, if that is agreeable to everybody concerned.

Mr. Whipple, will you be good enough to identify yourself and present your paper?

STATEMENT OF OLIVER M. WHIPPLE, FINANCIAL VICE PRESIDENT, ACCOMPANIED BY R. V. SYKES, ADMINISTRATIVE ASSISTANT, MUTUAL LIFE INSURANCE CO. OF NEW YORK

Mr. Whipple. My name is Oliver M. Whipple, and I am financial vice president of the Mutual Life Insurance Co. of New York. I have been associated with the company for approximately 20 years.

This is Mr. Sykes on my right, who will attempt to provide me with detailed answers to questions as they occur.

Mr. Chairman, I have been asked to give consideration and an answer to the question:

> If existing restrictions on qualified investments for life insurance companies were eliminated entirely, how would you alter the proportions for holdings of your present portfolio?

As you know, life-insurance companies domiciled in the various States of the Union are governed by the laws of their respective States as to the type and kind of investments they can make.

In New York State the investment provisions of the insurance law have shown a continuing development over the years. After the Hughes' investigations in 1906, the life companies were narrowly confined in their non-Government investments to first mortgage bonds, certain mortgages on real estate and little else. Later unsecured loans to companies with a good earnings record were added as was permission to invest to a limited degree in preferred stocks.

Year by year detailed permissions and limitations thereon have been woven into the law. At the present time, it may be said, in a general way and ignoring all refinements of legal language, that life-insurance companies in New York State may invest in the debt obligations of any solvent American corporation which are secured either by specific property or by a long record of steady earnings. They may buy not more than 10 percent of the preferred stock of seasoned corporations. Such insurance companies may also make conservative mortgage loans, FHA mortgages, and, to a sharply limited extent, invest in income-producing real estate.

Let me set forth a few general considerations about life-insurance investments before proceeding to some more specific facts.

Life-insurance funds, like all investment funds, generally tend toward areas of need. This happens almost inevitably because areas of need bid most for and offer a more attractive return. This tendency can be shown by historical data which clearly indicates that investment and the development of the United States have proceeded hand in hand. When the railroads were being built, large investment went into that field. Similarly the public utilities, the petroleum industry, the automobile industry and others have in periods of growth attracted large amounts of investment capital.

But this tendency of funds to flow toward need is somewhat restrained for life-insurance funds essentially because they are other people's money. It is of prime importance that the moneys paid in premiums be kept safe and available as needed for the payments of benefits guaranteed. While it is also important that in order to fulfill the company's contract such funds provide a return, they cannot be risked so freely as an individual can do with his own resources.

For these reasons, from the very establishment of life insurance in the United States, governmental authorities have imposed restrictions and restraints and even beyond the restraints imposed by government, there are other limitations which prudence and experience have shown to be necessary.

Since the highest possible return consistent with safety must be sought for other people's money, groups of investments which customarily have shown high loss rates, or which are inordinately expensive to make or to administer cannot be regarded as appropriate.

But these legal restrictions, plus the restraints suggested by prudence and experience, have not in any sense made the investment of life-insurance funds a static or an unchanging operation. Within restraints there is room for, and there has in fact been much flexibility and responsiveness to the needs of the economy and society.

Furthermore, as conditions have changed and as experience has developed, just as there have been changes in the law to admit new types of investment, there have been extensive changes over the years in management's views as to what is prudent which have brought about a steadily widening area of insurance company investment activities.

To provide some background for an answer to the question which the committee has propounded, it might be well to look at the investment portfolio of the Mutual Life as it was constituted in 1928 and as it stood at the end of 1948. There is a statement before you setting forth such a comparison which I offer for the committee's consideration.

From it, you will note the profound changes which have taken place in the Mutual's investments in that relatively short space of time. For example, in 1928, 39 percent of the Mutual's assets were invested in the railroad industry; an industry which as of that time had practically come of age, and in the process had required large amounts of new capital over preceding years to further its development.

Conversely, in 1928 only 5 percent of the Mutual Life's assets were invested in the public-utility field—an industry at that time which was growing and over the ensuing years was to require large amounts of new capital to provide the services which the growth and the development of the country required if the economy was to expand and prosper.

At the end of 1948 the Mutual's investment in the railroad industry had been reduced to an insignificant amount, whereas its investment in the public-utility field had increased from $48,000,000 in 1928, or 5 percent of its assets, to $442,000,000, or 22 percent of its assets.

The CHAIRMAN. Might I interrupt to ask this: Was there any particular reason for making a comparison between 1928 and 1948, except that it covered 20 years?

Mr. WHIPPLE. Except that it covered 20 years and covered my experience with the company, sir.

The CHAIRMAN. Then with respect to the statement you have just made about Mutual's investment in the railroad industry, was that intended to be relative?

Mr. WHIPPLE. Relative.

The CHAIRMAN. So that you do not want to convey the impression that Mutual's railroad investments are now insignificant but only relatively so?

Mr. WHIPPLE. Relative in amount; yes, sir. I am sorry.

The CHAIRMAN. I think it was just open to two interpretations.

Mr. WHIPPLE. Yes, sir. May I continue?

The CHAIRMAN. Yes, sir; please do.

Mr. WHIPPLE. Perhaps even more illustrative of the change in legal and management approach to appropriate investment is the comparison of the Mutual Life's investment in the general industrial field in 1928 which consisted of approximately $14,000,000 or 1½ percent of assets, and the $414,000,000 so invested at the end of 1948, or approximately 21 percent of assets.

But the over-all totals do not tell the whole story. In 1928 Mutual's investments in the public-utility field were confined to 53 companies representing a selected number of outstanding companies, mainly serving metropolitan areas and ranging in size from $4,254,000 of net assets to $2,106,709,000 of net assets. Only one of the companies had assets of less than $10,000,000, nine had assets of less than $25,000,000, 17 less than $50,000,000, and 24 less than $100,000,000.

At the end of 1948 Mutual's public-utility investments were spread throughout 159 companies representing companies not only in metropolitan areas but also smaller communities and rural areas of the country, and ranging in size from $596,000 of net assets to $4,914,765,000 of net assets. Eighteen companies had assets of less than $10,000,-

000, 31 less than $25,000,000, 58 less than $50,000,000, and 96 less than $100,000,000.

Similarly in the industrial field, Mutual's investment in 1928 was confined to 21 companies ranging in size from $44,854,000 of net assets to $2,442,030,000 of net assets. Only two of the companies had assets less than $50,000,000. In 1948 Mutual's industrial investments were spread over 221 companies ranging in size from $423,000 of net assets to $2,949,964,000 of net assets. One hundred twenty-six companies, or 57 percent of the total number, had assets of less than $50,000,000, and of these 3 were less than $1,000,000, 29 were less than $5,000,000, 42 were less than $10,000,000, and 97 were less than $25,000,000.

Investment activites in the field of mortgage lending have been affected by much the same considerations.

The CHAIRMAN. May I ask at this point again—I observe that in both of these comparisons you give the figures of the number of companies which have less than so much assets.

Mr. WHIPPLE. Yes, sir.

The CHAIRMAN. Were those cumulative?

Mr. WHIPPLE. Those are cumulative; yes, sir.

The CHAIRMAN. For example, when you say 97 with less than $25,000,000, that includes all that went before?

Mr. WHIPPLE. That is exactly right, sir.

The CHAIRMAN. Did you make any computation of those more than $25,000,000 in industries and more than $100,000 in utilities?

Mr. WHIPPLE. Not for the purposes of this, but in arriving at these figures; yes, we could give you that figure.

The CHAIRMAN. I wish you would.

Mr. WHIPPLE. Mr. Sykes, can you work that out and give it?

Mr. Chairman, shall I proceed in the meantime?

The CHAIRMAN. Yes, sir.

Mr. WHIPPLE. In 1928 Mutual's mortgages were represented for the most part by large commercial loans centered around the city of New York and having an average size of $152,248. At the end of 1948 as a result of a shift in emphasis toward residential property, over 73 percent of urban mortgage loans held were secured by residential property of various kinds and the average loan of the entire portfolio had declined to $10,800.

Furthermore, since 1940 there has been a shift away from the New York area so that today only 31 percent of our loans are situated there, and the balance is spread throughout 42 States, and this outside of New York investment has an average size of $8,000. Similarly by reason of unfavorable experience before the turn of the century, the Mutual had no farm loans as such in 1928.

In 1946 we began in a relatively small way to lend on farm property and as of the present time—October 31, 1949—we have $11,500,000 invested in 847 farm properties of various kinds, including range land, located in 23 States and having an average size of $13,593. They range in size from $1,900 to $225,000.

Such a transfer of investment funds over a 20-year period was dictated in large part by the demands of the country's economy as a whole and the demonstrated ability of developing enterprise to command the confidence of the institutional investor. The entire process was one of evolution and not revolution, and it seems clearly demonstrated that life-insurance investment funds have tended to flow in the direction where the need for such funds is apparent and real.

Within these broad categories, however, other striking changes have taken place, and new types of investment have been pioneered. For instance, in the public-utility field the natural gas transmission industry began to expand and develop in the early 1930's and was to require substantial amounts of new capital for such expansion.

The Mutual made its first loan to this industry in 1935 in the amount of $2,000,000, and I recall the temerity with which such investment was made and the severe restrictions imposed by the indenture of mortgage whereby, among other things, gas-production property was effectively excluded as a base for further financing under the mortgage.

Experience over the years has demonstrated the essential nature of this industry to the economy and the fundamental nature of the security afforded, as a result of which Mutual's investment in natural gas transmission companies stood at $37,179,000 at the end of 1948 with an additional $31,000,000 of securities acquired in 1949 or a total as of the present time of approximately $68,000,000.

It might also be noted that ideas concerning gas-production property as a basis of loan value have been altered somewhat over time and today Mutual has loans on its books secured solely by such properties.

This brings us to another new field of investment which was entered into during this period. In the early 1940's the need for longer-term funds to finance the development of oil and gas production enterprises became apparent and after careful study the Mutual entered this field and after pioneering for a loan of $1,750,000 in 1944, has increased its investment in companies producing oil and natural gas to $18,340,000 at the end of 1948, with additional closings in 1949 and commitments as of the present date of $29,000,000. Many of these are secured by both oil and gas but $19,000,000 are secured solely by gas.

Mr. BUCHANAN. May I interrupt?

Mr. WHIPPLE. Yes, sir.

Mr. BUCHANAN. Just how many gas companies are there?

Mr. WHIPPLE. In number?

Mr. BUCHANAN. Yes.

Mr. WHIPPLE. I think it shows in the table.

The CHAIRMAN. May I interrupt and say that this shows a very remarkable expansion in the current year; does it not?

Mr. WHIPPLE. In this particular field; yes, sir.

The CHAIRMAN. For example, in gas transmission you acquired in 1949 an additional investment of $31,000,000.

Mr. WHIPPLE. That is right, sir.

The CHAIRMAN. Whereas, the total of your investment——

Mr. WHIPPLE. Was $37,000,000 before.

The CHAIRMAN. Prior to that it was only $37,000,000.

Mr. WHIPPLE. Yes, sir.

The CHAIRMAN. In other words, in a single year you have almost doubled your investment in this natural-gas field and in the oil and gas production enterprises; in 1949 you have made acquisitions and commitments totaling $29,000,000.

Mr. WHIPPLE. Yes; that is right.

The CHAIRMAN. In other words, in the current year in these two fields there has been a tremendous expansion of the economy.

Mr. WHIPPLE. Yes, I would say; also going back into the year before, Senator, because very often you make a commitment in one year and the actual investment is made in the following year and carries over; so I would call it at least 2 years, because you get a carry-over. When you cut it off at December 31, 1948, for example, part of this $31,000,000 might have been committed for in December—and I remember distinctly that did occur. So it did not all originate in 1 year.

The CHAIRMAN. And having, of course, made a careful survey of these investments, Mutual was convinced that the market for the product of the companies to which the loans were made is likely to hold up pretty well; is that right?

Mr. WHIPPLE. That is right, sir.

The CHAIRMAN. In other words, it seems to me that you are giving us a very rosy picture of your confidence in the future of business.

Mr. WHIPPLE. It leads in that direction, Senator.

The CHAIRMAN. Not much to weep about in this picture, is there?

Mr. WHIPPLE. I hope not. We have confidence.

The CHAIRMAN. When I read in the paper this morning that General Eisenhower was advising the people to go to jail in order to get security, it struck me that the general is not looking at the facts.

Mr. WHIPPLE. I saw that same thing, Senator. I did not quite know what he meant. Do you want the figure for gas transmission lines, sir? There were nine at the end of 1948, sir.

Mr. BUCHANAN. Thank you.

Mr. WHIPPLE. Another step of pioneering nature resulting in the opening up of a new investment outlet during the 1930's was the development of the consumer credit industry as an investment medium. Steady growth in the use of consumer credit during this period demonstrated the need for additional capital on the part of the installment finance and small-loan companies.

In times past many informed observers of the investment scene were prone to regard the operations of companies engaged in the furnishing of credit to the consumer as in the nature of glorified pawn shops and as such inadmissible to the supply of long-term credit.

After careful study of the experience in this field, which afforded convincing data as to the essential soundness of the industry, Mutual entered this field modestly in 1935 and has advanced additional funds to this industry over the years, so that at the end of 1948, $66,751,000 was so invested.

Furthermore, a substantial portion of this investment is represented by a type of security usually regarded as somewhat foreign to life-insurance company investment practice, namely, the subordinated debenture which involves the advancing of funds on a relatively long-term basis to companies engaged in the installment finance and small-loan business, whereby such advances are subordinate to all other sources of credit and although representing an obligation on the part of the borrower, in effect constitute a substitute for equity upon which current borrowings may be based.

The advent of the revenue bond in the field of municipal finance has also contributed to a broadening of investment practice over this period. In 1928, Mutual's municipal bonds included none which were payable solely from the revenues of a specific project or facility, such as waterworks, sewer, bridge, or highway. In 1948 of the $27,000,000 municipal bonds owned $18,691,000 or 69 percent were payable solely from revenues of a facility specifically dedicated for the purpose of debt retirement.

Mr. BUCHANAN. Are these principally municipal authorities?

Mr. WHIPPLE. Yes; generally speaking, they are municipal authorities formed for that purpose. Once in a while you will get a city which will issue bonds for water and it will be the obligation of the city itself, but payable only from the revenue of the waterworks system, but generally speaking, they take the form of authorities of various kinds.

The CHAIRMAN. Do you have any revenue bonds on municipal light plants?

Mr. WHIPPLE. Yes, sir.

The CHAIRMAN. How much?

Mr. WHIPPLE. Of that $27,000,000?

The CHAIRMAN. You may proceed and we will put it in later, unless you have the answer now.

Mr. SYKES. We have the answer for that acquired in 1948, which accounts for a substantial part of the portfolio. We bought five issues, totaling $3,300,000 in 1948 on public utilities operating companies.

The CHAIRMAN. Is that all you have?

Mr. SYKES. I think that is all we have; yes, sir.

The CHAIRMAN. Thank you.

Mr. WHIPPLE. Within the limits prescribed by law, the search for new investment outlets by life insurance companies generally is never ending and it is interesting to note that the trend appears definitely away from the historical and classical approach involving the pledge of physical security and more and more towards a reliance upon stability of earning power as a measure of acceptable investment quality.

For example, the use of the unsecured debenture in the industrial field as compared to the corporate mortgage has substantially increased over the past 20 years; so that as at the end of 1948, out of a total investment of $393,000,000 by Mutual in industrial obligations, only $84,000,000, or 21.4 percent were secured by mortgage.

Preferred stocks afford even more evidence of the trend toward the reliance upon stability of earning power as a satisfactory basis for investment. They were a brand new type of security made permissible in 1928. Again a cautious beginning was made and Mutual's holdings of preferred stocks at the end of 1928 amounted to $9,281,000 and consisted of 20 individual issues.

Preferred-stock holdings were increased over the ensuing years and despite the relatively temporary impact of the forces of depression on market values in the middle 1930's, Mutual's experience indicated that from the point of view of continuity of income and ultimate preservation of value, further expansion of this medium of investment was desirable. As a result, preferred-stock holdings as of December 31, 1948, amounted to $35,624,000 and consisted of 120 issues.

Another and more recent development along these same lines is the acquisition of real estate for investment purposes made possible by the amendment to the insurance law of the State of New York, as far as the Mutual is concerned, in 1946. This form of investment involves the outright purchase of real estate with all the incidences of ownership.

Through a process of gradual evolution, therefore, the character of the Mutual's investments has changed decidedly over recent years with the trend indicating a shift in emphasis from brick and mortar security to demonstrated stability of earning power as a measure of investment desirability.

In view of such a trend, it seems logical to suppose that if restrictions of all kinds were removed—and I certainly do not advocate such drastic action—a somewhat more accelerated movement in that direction would take place. Certainly some types of investments not now permitted to us would be made.

For example, we would undoubtedly increase our lending to the farmer, now limited by law to not more than 66⅔ percent of the fair value of land and buildings, to include as a basis for security, the farmer's livestock and equipment.

The CHAIRMAN. You operate under the New York law?

Mr. WHIPPLE. Yes, sir.

The CHAIRMAN. Why do you think the New York Legislature has such a prejudice against the farmer?

Mr. WHIPPLE. I do not think it is a prejudice.

The CHAIRMAN. What is the basis?

Mr. WHIPPLE. The basis is the mortgage law, which only provides for land and buildings.

The CHAIRMAN. But here is a limitation of 66⅔.

Mr. WHIPPLE. That is the same for urban property.

The CHAIRMAN. All properties?

Mr. WHIPPLE. Yes, sir.

The CHAIRMAN. Not for farmers alone?

Mr. WHIPPLE. Oh, no.

The CHAIRMAN. It seems to be stated that way.

Mr. WHIPPLE. It should have been stated that the basic law provides only for mortgages not more than 66⅔ percent of the fair value of land and buildings.

The CHAIRMAN. You see how the sentence reads?

Mr. WHIPPLE. Yes.

The CHAIRMAN. You say this:

> For example, they would undoubtedly increase our lending to the farmer, now limited by law to not more than 66⅔ percent of a fair value of land and buildings, to include as a basis for security, the farmer's livestock and equipment, thereby financing his entire needs in one package on a relatively long-term basis.

Mr. WHIPPLE. That is right, sir.

The CHAIRMAN. My inquiry was based upon the desire to learn whether you felt that the farmers' loans, because of the lack of security of the farmer as a whole, were less desirable.

Mr. WHIPPLE. That was the limitation provided by law for all mortgages, urban or farm. I was citing a single instance where expansion in lending might take place with a revision of the law to provide for other security as a basis for a loan.

The CHAIRMAN. In other words, you are not recommending to increase the percentage of the loan on livestock, but permission to include other items?

Mr. WHIPPLE. Exactly, sir.

Mr. SCOLL. You mean not recommending an increase in the percentage on real estate; do you not, Mr. Chairman?

The CHAIRMAN. To include livestock as a basis. You cannot do that now; is that right?

Mr. WHIPPLE. That is right. Also we would undoubtedly expand our lending to individuals and partnerships now prohibited by law. This would be particularly true in the oil and gas production field where the tax laws sometimes make it inadvisable for an individual or partnership to incorporate for the purpose of financing their needs. Certainly we would attack more vigorously the development of some techniques whereby we might participate safely, and to a limited extent, in equities of various kinds.

From the record of the past it seems clear that if all or some of the present restrictions on investment were removed, Mutual would explore all avenues of investment that might thereby be opened and would undoubtedly find new sources of profitable and safe investment.

I should insert a word of caution, however, that any changes in the restrictions governing life insurance investment should be approached with the most extreme care and that there would be dangers to the stability of the economy in unrestricted, ill-informed investment, which I believe would outweigh any advantages which otherwise might be gained. The best progress can be made, in my opinion, by a continuous and cautious, but constructive, study to encourage the removal of restrictions in a manner and to a degree that permits a reasonable experimentation in new forms of investment.

While this has been the tendency of the several State insurance departments, the growth of institutional investment and the need for a constant and free flow of funds into investment channels indicates that this tendency should be developed into a consistent policy.

(The supplemental data submitted by Mr. Whipple are as follows:)

DECEMBER 2, 1949.

Mr. DAVID E. SCOLL,
New York 4, New York.

DEAR MR. SCOLL: I am sending you herewith the replies to the statistical parts of your supplementary questionnaire of November 15, 1949, as modified by Dr. O'Leary's letter of November 18.

The figures for paragraph C cover the portfolio as it existed December 31, 1948. The figures for paragraph D cover gross acquisitions during the year 1948. We are also enclosing photostatic prints dated December 31, 1945, 1946, 1947, and 1948, which we regularly prepare for our own use and these show the net changes in the various categories for those years.

If there are any further data we can get for you, please let me know.

Sincerely,

O. M. WHIPPLE.

Mutual Life Insurance Co. of New York

B. Geographical distribution of investments,[1] *policy reserves,*[2] *and ratio of investments to reserves by region (as of Dec. 31, 1948)*

Region	Investments	Policy reserves	Percent of investments to reserves
	Percent	*Percent*	
New England	4.7	5.8	91.8
Middle Atlantic	21.1	26.9	88.1
East North Central	16.9	20.9	91.4
West North Central	6.9	9.0	88.5
South Atlantic	11.2	11.3	112.0
East South Central	4.9	5.1	110.0
West South Central	9.8	5.0	227.0
Mountain	3.4	4.5	86.0
Pacific	8.2	10.0	92.3
Territories and possessions	([3])	.1	6.0
United States	87.1	98.7	100.0
Foreign	4.1	1.3	378.8
Miscellaneous	8.8	.1	----------
Total assets	100.0	100.0	113.4

[1] Admitted assets.
[2] Includes policy reserves, supplementary contracts, life and no life.
[3] Less than 1/20 of 1 percent.

C. Portfolio data as of Dec. 31, 1948

	Companies or units	Principal amount
1. Manufacturing	137	$203,416,000
2. Trade (including merchandise)	15	15,813,000
2-A. Other industrial [1]	30	92,659,000
3. Electricity	108	266,158,000
Gas (distribution)	17	29,205,000
Water	6	7,300,000
Telephone	17	91,371,000
4. Railroads (equipment)	8	4,543,000
5. Other transportation:		
Air lines	2	3,980,000
Tractions	2	4,429,000
Pipe lines:		
Oil	2	7,933,000
Gas	9	37,179,000
6. 1- to 4-family residential real-estate mortgages	27,373	177,109,000
7. Multifamily residential real-estate mortgages	489	54,495,000
8. Multifamily real-estate direct investments	0	0
9. Mortgages on commercial real estate held for rental purposes	527	77,287,000
9-A. Other commercial real estate, including clubs, department stores, theaters, industrial plants, schools, vacant land	76	7,692,000
10. Mining, including oil and gas	35	91,515,000
11. U. S. Government securities	1	584,500,000
12. Municipals and other public authorities:		
Schools	4	3,000,000
Air terminal	1	5,000,000
Water and sewage	14	13,701,000
Public utility	5	3,391,000
Bridge and highway	2	1,950,000

[1] Includes banks and finance companies, motion pictures, printing and publishing.

D. Acquisitions in 1948

1. GEOGRAPHICAL LOCATION (BY LOCATION OF HEAD OFFICE ONLY) OF CORPORATE SECURITY INVESTMENTS BY STATES AND CITIES

State and city	Number of counties	Total loans by cities	Total loans by States
1. Alabama:			
1. Birmingham	3	$5,500,000	$5,500,000
2. California:			
2. San Francisco	4	11,600,000	
3. Los Angeles	2	2,225,000	
			13,825,000

D. Acquisitions in 1948—Continued

State and city	Number of counties	Total loans by cities	Total loans by States
Colorado:			
4. Denver	1	$1,000,000	
5. Pueblo	1	600,000	
			$1,600,000
4. Connecticut:			
6. New Haven	2	3,250,000	
7. Kensington	1	900,000	
8. Springdale	1	900,000	
			5,050,000
5. Delaware:			
9. Wilmington	1	2,000,000	2,000,000
6. District of Columbia:			
10. Washington	1	150,000	150,000
7. Florida:			
11. St. Petersburg	1	1,000,000	
12. Tampa	1	750,000	
13. Clewiston	1	2,500,000	
14. Pensacola	1	1,250,000	
			5,500,000
8. Georgia:			
15. Atlanta	1	400,000	400,000
9. Idaho:			
16. Boise	1	2,000,000	2,000,000
10. Illinois:			
17. Springfield	1	500,000	
18. Decatur	1	1,000,000	
19. Matoon	1	500,000	
20. Chicago	5	8,400,000	
21. East St. Louis	1	800,000	
			11,200,000
11. Indiana:			
22. Hammond	1	1,500,000	
23. South Bend	2	6,500,000	
			8,000,000
12. Iowa:			
24. Des Moines	2	4,000,000	
25. Centerville	1	750,000	
			4,750,000
13. Kansas:			
26. Kansas City	1	600,000	600,000
14. Kentucky:			
27. Louisville	3	2,950,000	2,950,000
15. Louisiana:			
28. New Orleans	1	1,000,000	
29. Shreveport	1	1,100,000	
			2,100,000
16. Maryland:			
30. Baltimore	1	250,000	250,000
17. Massachusetts:			
31. Greenfield	1	165,000	
32. Somerville	1	500,000	
			665,000
18. Michigan:			
33. Detroit	3	10,200,000	
34. Jackson	1	240,000	
			10,440,000
19. Minnesota:			
35. Minneapolis	7	14,700,000	
36. Fergus Falls	1	425,000	
			15,125,000
20. Missouri:			
37. Kansas City	5	3,350,000	
38. St. Louis	5	4,055,000	
			7,405,000
21. Nebraska:			
39. Omaha	2	4,500,000	4,500,000
22. New Hampshire:			
40. Manchester	1	1,000,000	1,000,000
3. New Jersey:			
41. Long Branch	1	1,500,000	
42. Newark		3,000,000	
			4,500,000
24. New Mexico:			
43. Albuquerque	1	2,000,000	2,000,000
25. New York:			
44. Ithaca	2	1,250,000	
45. New York	18	44,358,000	
46. Middletown	1	350,000	
47. Buffalo	1	167,000	
48. Rochester	1	1,000,000	
49. Poughkeepsie	1	50,000	
			47,175,000

D. Acquisitions in 1948—Continued

State and city	Number of counties	Total loans by cities	Total loans by States
26. Ohio:			
50. Newark	1	$2,000,000	
51. Cincinnati	1	41,000	
52. Cleveland	1	750,000	
			$2,791,000
27. Oklahoma:			
53. Oklahoma City	2	4,150,000	
54. Tulsa	2	1,390,000	
55. McAlester	1	2,300,000	
			7,840,000
28. Oregon:			
56. Portland	1	1,250,000	1,250,000
29. Pennsylvania:			
57. Scranton	1	600,000	
58. Pittsburgh	5	3,853,000	
59. Bethlehem	1	1,500,000	
60. Philadelphia	1	120,000	
			6,073,000
30. Tennessee:			
61. Memphis	1	3,000,000	
62. Chattanooga	1	400,000	
			3,400,000
31. Texas:			
63. Abilene	1	500,000	
64. Houston	5	5,937,000	
65. El Paso	2	4,387,000	
66. Corpu Christi	1	6,400,000	
67. Dallas	2	665,000	
			17,889,000
32. Utah:			
68. Cedar City	1	250,000	250,000
33. Virginia:			
69. Richmond	1	500,000	500,000
34. Wisconsin:			
70. Beloit	1	1,500,000	
71. West Allis	1	100,000	
			1,600,000
35. Wyoming:			
72. Cheyenne	1	1,275,000	1,275,000
Total, 35 States and District of Columbia, 72 Cities	134	201,553,000	201,553,000

2. BY SIZE OF INVESTMENT UNITS

[In thousands]

	0 to 250		251 to 500		501 to 1,000		1,000 to 5,000	
	Number of companies	Units	Number of companies	Units	Number of companies	Units	Number of companies	Units
Public utility bonds:								
Public	1	250	7	3,500	11	10,500	7	14,205
Direct	1	250	4	1,675	8	5,300	10	17,527
Preferred stocks	4	510	2	800		0		0
Total public utilities	6	1,010	13	5,975	19	15,800	17	31,732
Industrial and miscellaneous:								
Public	2	250	3	1,199	2	2,000	2	4,000
Direct	9	1,984	6	2,625	6	5,490	25	45,475
Preferred stocks	6	749	1	300		0		0
Total industrial and miscellaneous	17	2,983	10	4,124	8	7,490	27	49,475
Grand total bonds:								
Public	3	500	10	4,699	13	12,500	9	18,205
Direct	10	2,234	10	4,300	14	10,790	35	63,002
Preferred stocks	10	1,259	3	4,100		0		0
Total	23	3,993	23	10,099	27	23,290	44	81,207

D. Acquisitions in 1948—Continued

2. BY SIZE OF INVESTMENT UNITS

[In thousands]

	2,501 to 5,000		5,001 to 10,000		10,001 and over		Total	
	Number of companies	Units	Number of companies	Units	Number of companies	Units	Number of companies	Units
Public utility bonds:								
Public	2	5,979	1	7,500	-------	-------	29	41,934
Direct	4	12,585	-------	0	-------	-------	27	37,337
Preferred stocks	-------	0	-------	0	-------	-------	6	1,310
Total public utilities	6	18,564	1	7,500	-------	-------	62	80,581
Industrial and miscellaneous:								
Public	-------	0	-------	0	-------	0	9	7,449
Direct	6	24,000	3	20,400	1	12,500	56	112,474
Preferred stocks	-------	0	-------	0	-------	0	7	1,049
Total industrial and miscellaneous	6	24,000	3	20,400	1	12,500	72	120,972
Grand total bonds:								
Public	2	5,979	1	7,500	-------	0	38	49,383
Direct	10	36,585	3	20,400	1	12,500	83	149,811
Preferred stocks	-------	0	-------	0	-------	0	13	2,359
Total	12	42,564	4	27,900	1	12,500	134	201,553

3. PRODUCT OR SERVICE OF BORROWER

Product or service	Number of companies	Amount of loans
Public utility:		
Electric light and allied services	39	$34,510,000
Gas	14	28,516,000
Telephone	6	15,055,000
Water	3	2,500,000
Total public utility	62	80,581,000
Industrial:		
Banks	1	150,000
Brewing and distilling	5	4,096,000
Building materials and equipment	2	6,500,000
Chemicals	4	1,820,000
Coal and coke	1	41,000
Electric products	2	2,900,000
Finance companies	13	38,750,000
Food and food processing	7	13,600,000
Household furnishings	1	200,000
Leather and shoes	1	1,500,000
Machinery	5	3,215,000
Metals—nonferrous	1	1,000,000
Office equipment	1	2,250,000
Petroleum	12	29,292,000
Printing and publishing	4	3,875,000
Pulp and paper	4	4,650,000
Retail trade	6	6,033,000
Specialties	1	1,000,000
Textiles	1	100,000
Total industrial	72	120,972,000
Grand total	134	201,553,000

D. Acquisitions in 1948—Continued

4. PURPOSE OF LOAN [In thousands]

	Number of companies	Bought in open market	Number of companies	Construction	Number of companies	Refunding bank loans	Number of companies	Acquisition of property	Number of companies	Refunding	Number of companies	Working capital	Number of companies	Total
Public utility:														
Electric light and allied services	2	$300	27	$25,985	10	$8,225							30	$34,510
Gas	1	100	10	21,916	1	2,500	1	$500	1	$3,500			14	28,516
Telephone			2	850	4	14,205							6	15,055
Water					3	2,500							3	2,500
Total public utility	3	400	39	48,751	18	27,430	1	500	1	3,500			62	80,581
Industrial and miscellaneous	10	2,048	23	38,692	12	17,117	5	6,715	6	13,700	16	$42,700	72	120,972
Grand total	13	2,448	62	87,443	30	44,547	6	7,215	7	17,200	16	42,700	134	201,553

5. INTEREST RATES [In thousands]

	0 to 2.50		2.51 to 2.75		2.76 to 3.00		3.01 to 3.25		3.26 to 3.50		3.51 and over		Total	
	Number of companies	Units	Number of companies	Units	Number of companies	Units	Number of companies	Units	Number of companies	Units	Number of companies	Units	Number of companies	Units
Public-utility bonds:														
Public		0	1	2,979	12	13,205	16	25,750		0		0	29	41,934
Direct		0		0	3	4,750	14	18,235	5	6,302	5	8,050	27	37,337
Preferred stocks		0		0							6	1,310	6	1,310
Total public utility		0	1	2,979	15	17,955	30	43,985	5	6,302	11	9,360	62	80,581
Industrial and miscellaneous:														
Public		0	1	2,000	6	4,299	1	150		0	1	1,000	9	7,449
Direct	2	9,000	2	5,100	10	26,580	6	17,000	17	23,767	19	31,027	56	112,474
Preferred stocks	1	[1]41		0		0		0	2	208	4	800	7	1,049
Total industrial and miscellaneous	3	9,041	3	7,100	16	30,879	7	17,150	19	23,975	24	32,827	72	120,972
Grand total bonds:														
Public		0	2	4,979	18	17,504	17	25,900		0	1	1,000	38	49,383
Direct	2	9,000	2	5,100	13	31,330	20	35,235	22	30,069	24	39,077	83	149,811
Preferred stocks	1	[1]41		0		0		0	2	208	10	2,110	13	2,359
Total	3	9,041	4	10,079	31	48,834	37	61,135	24	30,277	35	42,187	134	201,553

D. Abquisitions in 1948—Continued

7. FORM OF INVESTMENT CONTRACTS

	Units	Principal amount
Purchase and lease-back	10	$8, 037, 000
Mortgage bonds	67	90, 672, 000
Debentures	50	105, 070, 000
Convertible bonds	2	3, 452, 000
Preferred stocks	12	2, 318, 000
Common stock	1	[1] 41, 000

[1] Received in conversion for delivery to buyer.

E. Manner of placement

	Principal amount	Percent
2. Security purchases through underwriters (excludes preferred stocks):		
Public utility:		
Public	$41, 934, 000	52. 9
Direct	37, 337, 000	47. 1
	79, 271, 000	100. 0
Industrial:		
Public	7, 449, 000	6. 2
Direct	112, 474, 163	93. 8
	119, 923, 163	100. 0
Total public utility and industrial:		
Public	49, 383, 000	24. 8
Direct	149, 811, 163	75. 2
	199, 194, 163	100. 0

Summary of purchases, sales, and maturities and redemptions, including exchanges

YEAR ENDED DEC. 31, 1945

[Principal amount]

	Purchases or exchanges	Effective rate	Percent total	Sales	Maturities, redemptions, or exchanges	Net change
Canada	$3, 564, 637. 60	3. 13	0. 8	$1, 125, 000	$2, 114, 000. 00	+$325, 637. 60
Foreign government	0			48, 700	0	−48, 700. 00
United States Government	270, 500, 000. 00	2. 40	57. 4	181, 750, 000	0	+88, 750, 000. 00
United States municipal	0			0	318, 000. 00	−318, 000. 00
Railroad including equipment	0			29, 963, 000	8, 511, 000. 00	−38, 474, 000. 00
Public utility:						
Bonds	96, 229, 000. 00	2. 89	20. 4	11, 608, 000	73, 179, 000. 00	+11, 442, 000. 00
Preferred	5, 395, 450. 00	4. 10	1. 1	60, 000	272, 200. 00	+5, 073, 250. 00
Industrial:						
Bonds	88, 011, 500. 00	3. 23	18. 7	11, 413, 000	48, 143, 838. 11	+28, 454, 661. 89
Preferred	7, 478, 900. 00	3. 85	1. 6	814, 000	1, 687, 000. 00	+4, 977, 900. 00
Total	471, 179, 487. 60	2. 69	100. 0	236, 771, 700	134, 225, 038. 11	+100, 182, 749. 49

Summary of purchases, sales, and maturities and redemptions, including exchanges—Continued

COMPARABLE FIGURES OF PREVIOUS YEARS

	Purchases or exchanges	Effective rate	Sales	Maturities, redemptions, or exchanges	Net increase
1945	$471, 179, 487. 60	2. 69	$236, 771, 700. 00	$134, 225, 038. 11	$100, 182, 749. 49
1944	640, 327, 700. 00	2. 44	470, 107, 068. 77	67, 389, 944. 34	102, 830, 686. 89
1943	376, 922, 940. 00	2. 36	275, 665, 000. 00	17, 882, 228. 41	83, 375, 711. 59
1942	465, 777, 743. 50	2. 51	383, 049, 043. 50	38, 738, 100. 00	43, 990, 600. 00
1941	379, 434, 300. 00	2. 34	225, 721, 600. 00	93, 190, 579. 15	60, 522, 120. 85
1940	163, 901, 750. 00	2. 40	21, 829, 500. 00	57, 514, 224. 38	84, 558, 025. 62
1939	151, 624, 500. 00	2. 46	30, 367, 243. 00	53, 368, 266. 00	67, 888, 991. 00
1938	82, 550, 000. 00	3. 14	1, 929, 560. 00	27, 721, 100. 00	52, 899, 340. 00
1937	101, 576, 000. 00	2. 87.	7, 432, 300. 00	29, 297, 100. 00	64, 846, 600. 00
1936	166, 155, 000. 00	2. 36	7, 957, 000. 00	51, 340, 000. 00	106, 858, 000. 00
1935	135, 562, 602. 00	2. 57	4, 592, 294. 00	42, 504, 535. 00	88, 465, 773. 00
1934	68, 174, 684. 00	2. 25	6, 643, 200. 00	11, 462, 553. 00	50, 068, 931. 00
1933	18, 036, 000. 00	2. 37	6, 002, 140. 00	4, 591, 993. 00	7, 441, 867. 00
1932	2, 368, 970. 00	5. 16	6, 617, 614. 00	4, 920, 660. 00	9, 169, 304. 00
1931	22, 842, 845. 00	4. 75	11, 232, 926. 00	5, 483, 773. 00	6, 126, 145. 00
1930	38, 087, 000. 00	4. 86	28, 613, 632. 00	5, 933, 915. 00	3, 539, 452. 00
1929	35, 888, 574. 00	4. 96	17, 841, 522. 00	9, 534, 768. 00	8, 512, 284. 00
1928	36, 718, 691. 00	4. 74	9, 357, 458. 00	9, 301, 547. 00	18, 059, 687. 00
1927	37, 612, 389. 00	4. 68	10, 798, 768. 00	8. 977, 807. 00	17, 835. 813. 00

YEAR ENDED DEC. 31, 1946

[Principal amount]

	Purchases or exchanges	Effective rate	Percent total	Sales	Maturities, redemptions, or exchanges	Net change
U. S. Government	$142, 600, 000. 00	2. 42	37. 59	$195, 055, 000	0	−$52, 455, 000. 00
Canada	22, 286, 000. 00	3. 39	5. 87	0	$5, 671, 327. 52	+16, 614, 672. 48
Foreign	194, 800. 00	1. 88	0. 05	0	244, 500. 00	−49, 700. 00
United States municipal	1, 965, 000. 00	2. 95	0. 52	215, 000	25, 000. 00	+1, 725, 000. 00
Railroad, including equipment	0	----	----	6, 270, 000	1, 655, 000. 00	−7, 925, 000. 00
Public Utility:						
Bonds	67, 769, 000. 00	2. 74	17. 87	1, 500, 000	37, 003, 500. 04	+29, 265, 499. 96
Stocks	4, 120, 000. 00	3. 90	1. 09	100, 000	421, 800. 00	+3, 598, 200. 00
Industrial:						
Bonds	132, 637, 644. 66	2. 99	34. 97	0	47, 344, 256. 68	+85, 293, 387. 98
Stocks	7, 728, 500. 00	3. 63	2. 04	190, 000	1, 760, 900. 00	+5, 777, 600. 00
Total	379, 300, 944. 66	2. 77	100. 00	203, 330, 000	94, 126, 284. 24	+81, 844, 660. 42

COMPARABLE FIGURES OF PREVIOUS YEARS

	Purchases or exchanges	Effective rate	Sales	Maturities, redemptions, or exchanges	Net increase
1946	$379, 300, 944. 66	2. 77	$203, 330, 000. 00	$94, 126, 284. 24	$81, 844, 660. 42
1945	471, 179, 487. 60	2. 69	236, 771, 700. 00	134, 225, 038. 11	100, 182, 749. 49
1944	640, 327, 700. 00	2. 44	470, 107, 068. 77	67, 389, 944. 34	102, 830, 686. 89
1943	376, 922, 940. 00	2. 36	275, 665, 000. 00	17, 882, 228. 41	83, 375, 711. 59
1942	465, 777, 743. 50	2. 51	383, 049, 043. 50	38, 738, 100. 00	43, 990, 600. 00
1941	379, 434, 300. 00	2. 34	225, 721, 600. 00	93, 190, 579. 15	60, 522, 120. 85
1940	163, 901, 750. 00	2. 40	21, 829, 500. 00	57, 514, 224. 38	84, 558, 025. 62
1939	151, 624, 500. 00	2. 46	30, 367, 243. 00	53, 368, 266. 00	67, 888, 991. 00
1938	82, 550, 000. 00	3. 14	1, 929, 560. 00	27, 721, 100. 00	52, 899, 340. 00
1937	101, 576, 000. 00	2. 87	7, 432, 300. 00	29, 297, 100. 00	64, 846, 600. 00
1936	106, 155, 000. 00	2. 36	7, 957, 000. 00	51, 340, 000. 00	106, 858, 000. 00
1935	135, 562, 602. 00	2. 57	4, 592, 294. 00	42, 504, 535. 00	88, 465, 773. 00
1934	68, 174, 684. 00	2. 25	6, 643, 200. 00	11, 462, 553. 00	50, 068, 931. 00
1933	18, 036, 000. 00	2. 37	6, 002, 140. 00	4, 591, 993. 00	7, 441, 867. 00
1932	2, 368, 970. 00	5. 16	6, 617, 614. 00	4, 920, 660. 00	−9, 169, 304. 00
1931	22, 842, 845. 00	4. 75	11, 232, 926. 00	5, 483, 773. 00	6, 126, 145. 00
1930	38, 087, 000. 00	4. 86	28, 613, 632. 00	5, 933, 915. 00	3, 539, 452. 00
1929	35, 888, 574. 00	4. 96	17, 841, 522. 00	9, 534, 768. 00	8, 512, 284. 00
1928	36, 718, 691. 00	4. 74	9, 357, 458. 00	9, 301, 547. 00	18, 059, 687. 00
1927	37, 612, 389. 00	4. 68	10, 798, 768. 00	8, 977, 807. 00	17, 835, 813. 00

Summary of purchases, sales, and maturities and redemptions, including exchanges—Continued

YEAR ENDED DEC. 31, 1947

[Principal amount]

	Purchases or exchanges	Effective rate	Percent total	Sales	Maturities, redemptions, or exchanges [1]	Net change
U. S. Treasury bonds	$10, 100, 000. 00	2. 50	4. 15	$150, 691, 300. 00	0	−$140, 591, 300. 00
U. S. Treasury bills	35, 000, 000. 00	(. 87)	14. 40	2, 000, 000. 00	0	+33, 000, 000. 00
Canada	0	--------	--------	0	$2, 349, 327. 52	−2, 349, 327. 52
Foreign	0	--------	--------	0	36, 466. 00	−36, 466. 00
United States municipal	3, 430, 000. 00	2. 91	1. 41	0	25, 000. 00	+3, 405, 000. 00
Railroad, including equipment	0	--------	--------	0	912, 000. 00	−912, 000. 00
Public utility:						
Bonds	85, 191, 000. 00	2. 88	35. 06	2, 814, 144. 70	20, 364, 355. 26	+62, 012, 500. 04
Stocks	3, 316, 000. 00	4. 18	1. 36	1, 447, 200. 00	1, 015, 000. 00	+853, 800. 00
Industrial:						
Bonds	101, 350, 885. 09	3. 25	41. 69	400, 000. 00	38, 870, 160. 14	+62, 080, 724. 95
Stocks	4, 700, 000. 00	3. 64	1. 93	2, 692, 100. 00	819, 800. 00	+1, 188, 100. 00
Total	243, 087, 885. 09	[2] 3. 08	100. 00	160, 044, 744. 70	64, 392, 108. 92	+18, 651, 031. 47

[1] Excludes interchange of coupon and registered bonds.
[2] Excludes Treasury bills.

COMPARABLE FIGURES OF PREVIOUS YEARS

	Purchases or exchanges	Effective rate	Sales	Maturities, redemptions, or exchanges	Net increase
1947	$243, 087, 885. 09	3. 08	$160, 044, 744. 70	$64, 392, 108. 92	$18, 651, 031. 47
1946	379, 300, 944. 66	2. 77	203, 330, 000. 00	94, 126, 284. 24	81, 844, 660. 42
1945	471, 179, 487. 60	2. 69	236, 771, 700. 00	134, 225, 038. 11	100, 182, 749. 49
1944	640, 327, 700. 00	2. 44	470, 107, 068. 77	67, 389, 944. 34	102, 830, 686. 89
1943	376, 922, 940. 00	2. 36	275, 665, 000. 00	17, 882, 228. 41	83, 375, 711. 59
1942	465, 777, 743. 50	2. 51	383, 049, 043. 50	38, 738, 100. 00	43, 990, 600. 00
1941	379, 434, 300. 00	2. 34	225, 721, 600. 00	93, 190, 579. 15	60, 522, 120. 85
1940	163, 901, 750. 00	2. 40	21, 829, 500. 00	57, 514, 224. 38	84, 558, 025. 62
1939	151, 624, 500. 00	2. 46	30, 367, 243. 00	53, 368, 266. 00	67, 888, 991. 00
1938	82, 550, 000. 00	3. 14	1, 929, 560. 00	27, 721, 100. 00	52, 899, 340. 00
1937	101, 576, 000. 00	2. 87	7, 432, 300. 00	29, 297, 100. 00	64, 846, 600. 00
1936	106, 155, 000. 00	2. 36	7, 957, 000. 00	51, 340, 000. 00	106, 858, 000. 00
1935	135, 562, 602. 00	2. 57	4, 592, 294. 00	42, 504, 535. 00	88, 465, 773. 00
1934	68, 174, 684. 00	2. 25	6, 643, 200. 00	11, 462, 553. 00	50, 068, 931. 00
1933	18, 036, 000. 00	2. 37	6, 002, 140. 00	4, 591, 993. 00	7, 441, 867. 00
1932	2, 368, 970. 00	5. 16	6, 617, 614. 00	4, 920, 660. 00	−9, 169, 304. 00
1931	22, 842, 845. 00	4. 75	11, 232, 926. 00	5, 483, 773. 00	6, 126, 145. 00
1930	38, 087, 000. 00	4. 86	28, 613, 632. 00	5, 933, 915. 00	3. 539, 452. 00
1929	35, 888, 574. 00	4. 96	17, 841, 522. 00	9, 534, 768. 00	8, 512, 284. 06
1928	36, 718, 691. 00	4. 74	9, 357, 458. 00	9, 301, 547. 00	18, 059, 687. 00
1927	37, 612, 389. 00	4. 68	10, 798, 768. 00	8, 977, 807. 00	17, 835, 813. 00

YEAR ENDED DEC. 31, 1948 (EXCLUDES INTERCHANGE OF COUPON AND REGISTERED BONDS)

[Principal amount]

	Purchases or exchanges	Effective rate	Percent total	Sales	Maturities, redemptions, or exchanges	Net change
U. S. Treasury bonds	$76, 005, 000. 00	2. 48	14. 14	$242, 605, 000	$0. 00	−$166,600,000.00
U. S. Treasury bills	236, 000, 000. 00	(. 94)	43. 91	145, 900, 000	123, 100, 000. 00	−33, 000, 000. 00
Canada	0. 00	--------	--------	6, 495, 000	177, 327. 52	−6, 672, 327. 52
Foreign	0. 00	--------	--------	24, 350	0. 00	−24, 350. 00
United States municipal	22, 902, 000. 00	3. 06	4. 26	1, 115, 000	50, 000. 00	+21, 737, 000. 00
Railroad equipment trusts	1, 000, 000. 00	2. 76	. 19	0	822, 000. 00	+178, 000. 00
Public utility:						
Bonds	79, 271, 000. 00	3. 17	14. 75	11, 999, 000	2, 837, 000. 00	+64, 435, 000. 00
Stocks	1, 310, 000. 00	4. 31	. 24	0	520, 000. 00	+790, 000. 00
Industrial:						
Bonds	119, 923, 162. 85	3. 38	22. 31	2, 000, 000	29, 768, 237. 65	+88, 154, 925. 20
Stocks	1, 049, 000. 00	3. 99	. 20	2, 371, 000	136, 600. 00	−1, 458, 600. 00
Total	537, 460, 162. 85	[1] 3. 07	100. 00	412, 509, 350	157, 411, 165. 17	−32, 460, 352. 32

[1] Excludes Treasury bills, GMAC short-term note and General Finance discount notes.

Summary of purchases, sales, and maturities and redemptions, including exchanges—Continued

COMPARABLE FIGURES OF PREVIOUS YEARS

	Purchases or exchanges	Effective rate	Sales	Maturities, redemptions, or exchanges	Net increase
1948	$537, 460, 162. 85	3. 07	$412, 509, 350. 00	$157, 411, 165. 17	−$32, 460, 352. 32
1947	243, 087, 885. 09	3. 08	160, 044, 744. 70	64, 392, 108. 92	18, 651, 031. 47
1946	379, 300, 944. 66	2. 77	203, 330, 000. 00	94, 126, 284. 24	81, 844, 660. 42
1945	471, 179, 487. 60	2. 69	236, 771, 700. 00	134, 225, 038. 11	100, 182, 749. 49
1944	640, 327, 700. 00	2. 44	470, 107, 068. 77	67, 389, 944. 34	102, 830, 686. 89
1943	376, 922, 940. 00	2. 36	275, 665, 000. 00	17, 882, 228. 41	83, 375, 711. 59
1942	465, 777, 743. 50	2. 51	383, 049, 043. 50	38, 738, 100. 00	43, 990, 600. 00
1941	379, 434, 300. 00	2. 34	225, 721, 600. 00	93, 190, 579. 15	60, 522, 120. 85
1940	163, 901, 750. 00	2. 40	21, 829, 500. 00	57, 514, 224. 38	84, 558, 025. 62
1939	151, 624, 500. 00	2. 46	30, 367, 243. 00	53, 368, 266. 00	67, 888, 991. 00
1938	82, 550, 000. 00	3. 14	1, 929, 560. 00	27, 721, 100. 00	52, 899, 340. 00
1937	101, 576, 000. 00	2. 87	7, 432, 300. 00	29, 297, 100. 00	64, 846, 600. 00
1936	106, 155, 000. 00	2. 36	7, 957, 000. 00	51, 340, 000. 00	106, 858, 000. 00
1935	135, 562, 602. 00	2. 57	4, 592, 294. 00	42, 504, 535. 00	88, 465, 773. 00
1934	68, 174, 684. 00	2. 25	6, 643, 200. 00	11, 462, 553. 00	50, 068, 931. 00
1933	18, 036, 000. 00	2. 37	6, 002, 140. 00	4, 591, 993. 00	7, 441, 867. 00
1932	2, 368, 970. 00	5. 16	6, 617, 614. 00	4, 920, 660. 00	−9, 169, 304. 00
1931	22, 842, 845. 00	4. 75	11, 232, 926. 00	5, 483, 773. 00	6, 126, 145. 00
1930	38, 087, 000. 00	4. 86	28, 613, 632. 00	5, 933, 915. 00	3, 539, 452. 00
1929	35, 888, 574. 00	4. 96	17, 841, 522. 00	9, 534, 768. 00	8, 512, 284. 00

Total admitted asset values

[In millions of dollars]

Year	Securities															
	United States Government		United States Municipals		Canadians		Other foreign		Railroads		Public utilities		Industrials		Total securities	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
1927	81.0	9.4	12.1	1.4	1.7	0.2	5.1	0.6	365.2	42.3	32.9	3.8	7.8	0.9	505.8	58.6
1928	74.9	8.1	13.8	1.5	6.6	.7	3.9	.4	363.8	39.2	48.2	5.2	14.4	1.5	525.6	56.7
1929	63.9	6.5	16.3	1.7	12.0	1.2	3.3	.3	358.5	36.2	62.3	6.3	18.1	1.8	534.3	54.0
1930	47.9	4.5	16.7	1.6	14.2	1.4	2.5	.2	351.9	33.4	81.4	7.7	23.9	2.3	538.6	51.1
1931	40.8	3.7	17.8	1.6	14.5	1.3	2.0	.2	347.5	31.4	95.5	8.6	26.6	2.5	544.7	49.3
1932	40.8	3.6	16.5	1.4	14.4	1.3	.9	.1	340.8	30.2	96.5	8.6	24.5	2.2	534.4	47.4
1933	54.5	4.8	19.6	1.7	14.2	1.3	.7	.1	326.3	29.1	96.1	8.6	22.1	2.0	533.6	47.6
1934	104.7	9.0	24.8	2.1	14.0	1.2	.8	.1	311.0	26.8	100.5	8.6	21.1	1.8	576.8	49.7
1935	175.3	14.2	38.8	3.1	14.0	1.2	.6	--------	285.1	23.0	110.5	8.9	36.2	2.9	660.7	53.3
1936	267.7	20.5	56.7	4.3	9.4	.7	1.1	.1	278.9	21.3	123.2	9.5	37.7	2.9	774.6	59.3
1937	313.3	23.2	57.1	4.2	7.9	.6	.8	.1	253.2	18.8	131.9	9.8	52.2	3.9	816.5	60.6
1938	333.5	23.8	63.3	4.5	7.4	.6	.5	--------	239.0	17.1	161.0	11.5	57.4	4.1	862.2	61.6
1939	368.1	25.5	73.1	5.1	7.1	.5	.4	--------	220.5	15.3	190.4	13.2	66.7	4.6	926.3	64.2
1940	401.9	27.1	77.5	5.2	7.1	.5	.3	--------	214.7	14.4	202.7	13.7	104.5	7.0	1,008.7	67.9
1941	482.0	31.3	52.6	3.4	21.6	1.4	.2	--------	178.7	11.6	239.4	15.5	119.3	7.7	1,093.8	70.9
1942	643.9	40.6	50.6	3.2	42.3	2.6	.1	--------	95.4	6.0	231.7	14.6	110.6	7.0	1,174.6	74.0
1943	733.0	44.4	48.6	2.9	53.7	3.3	.1	--------	65.6	4.0	232.1	14.1	132.7	8.0	1,265.8	76.7
1944	858.5	50.0	.5	--------	51.5	3.0	.4	--------	51.2	3.0	263.6	15.4	144.6	8.4	1,370.3	79.8
1945	945.1	52.6	.2	--------	51.8	2.9	.4	--------	13.2	.7	281.3	15.6	179.6	10.0	1,471.6	81.8
1946	893.6	48.4	1.9	.1	67.2	3.6	.4	--------	5.3	.3	314.7	17.1	269.3	14.7	1,552.4	84.2
1947	785.5	40.8	5.4	.3	64.0	3.4	.3	--------	4.4	.2	377.7	19.6	330.3	17.2	1,567.6	81.5
1948	586.1	29.3	27.4	1.4	57.7	2.9	.3	--------	4.5	.2	442.8	22.1	414.8	20.9	1,533.6	76.8

Total admitted asset values—Continued

Year	Mortgage loans		Real estate		Policy loans		Cash		All others		Total
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount
1927	208. 6	24. 3	9. 2	1. 1	111. 6	13. 0	3. 0	. 3	23. 7	2. 7	861. 9
1928	240. 9	26. 0	9. 2	1. 0	123. 2	13. 3	2. 9	. 3	25. 5	2. 7	927. 3
1929	270. 0	27. 3	9. 2	. 9	144. 7	14. 6	4. 6	. 5	28. 0	2. 8	990. 9
1930	300. 1	28. 5	9. 2	. 9	169. 2	16. 1	3. 8	. 4	31. 2	3. 0	1, 052. 2
1931	309. 9	28. 0	10. 3	. 9	200. 6	18. 2	6. 9	. 6	33. 9	3. 0	1, 106. 2
1932	300. 4	26. 6	20. 2	1. 8	220. 8	19. 6	15. 7	1. 4	35. 7	3. 2	1, 127. 2
1933	285. 9	25. 5	30. 5	2. 7	201. 4	18. 0	32. 2	2. 9	36. 4	3. 3	1, 119. 9
1934	258. 0	22. 2	51. 0	4. 4	187. 7	16. 2	52. 5	4. 5	34. 5	3. 0	1, 160. 5
1935	238. 1	19. 2	54. 2	4. 4	177. 8	14. 4	74. 9	6. 0	33. 3	2. 7	1, 239. 0
1936	225. 0	17. 2	55. 5	4. 2	166. 6	12. 7	56. 0	4. 3	30. 5	2. 3	1, 308. 3
1937	224. 2	16. 6	57. 3	4. 2	163. 4	12. 1	56. 8	4. 2	30. 8	2. 3	1, 349. 1
1938	224. 8	16. 1	60. 6	4. 3	159. 6	11. 4	61. 9	4. 4	30. 4	2. 2	1, 399. 4
1939	222. 5	15. 4	58. 4	4. 0	146. 4	10. 1	59. 7	4. 1	31. 2	2. 2	1, 444. 5
1940	222. 4	15. 0	59. 2	4. 0	133. 6	9. 0	32. 8	2. 2	28. 2	1. 9	1, 484. 9
1941	227. 5	14. 8	53. 0	3. 4	121. 0	7. 9	19. 6	1. 3	27. 1	1. 7	1, 542. 0
1942	222. 0	14. 0	48. 6	3. 1	105. 6	6. 6	11. 7	. 7	24. 9	1. 6	1, 587. 5
1943	222. 2	13. 4	40. 9	2. 5	89. 7	5. 4	9. 8	. 6	22. 9	1. 4	1, 651. 3
1944	207. 8	12. 1	29. 3	1. 7	77. 7	4. 5	10. 2	. 6	22. 3	1. 3	1, 717. 6
1945	200. 5	11. 2	25. 3	1. 4	68. 6	3. 8	10. 6	. 6	21. 8	1. 2	1, 798. 4
1946	173. 2	9. 4	21. 2	1. 1	67. 2	3. 6	9. 7	. 5	22. 0	1. 2	1, 845. 7
1947	213. 5	11. 1	36. 3	1. 9	73. 6	3. 8	9. 8	. 5	23. 9	1. 2	1, 924. 7
1948	306. 3	15. 3	39. 8	2. 0	81. 6	4. 1	9. 7	. 5	26. 1	1. 3	1, 997. 1

The CHAIRMAN. Are there any specific recommendations which you are willing to make with respect to the removal of restrictions?

Mr. WHIPPLE. We suggested and proposed to the State legislature last January, I think it was, that serious study and consideration be given to the question of permitting common stocks with some limitation on amount as a permissible form of investment. I believe that that proposal is under consideration by a subcommittee of the legislature at the present time.

The CHAIRMAN. When you say "we," you mean the Mutual or the industry as a whole?

Mr. WHIPPLE. No, sir; the Mutual.

The CHAIRMAN. To what extent does the life-insurance industry join in that attitude?

Mr. WHIPPLE. That I cannot answer. There seems to be a variety of opinions on it, Senator. Mr. Josephs, I think, yesterday indicated that he favored the opening up of common stocks and that they would certainly study the possibilities inherent in them.

The CHAIRMAN. I notice there is a very cautious approach to it, but there is a definite approach.

Mr. WHIPPLE. Yes, sir.

The CHAIRMAN. And 10 States already have this authority? Am I right in that? That is my recollection of the testimony.

Mr. WHIPPLE. There are States, and the exact number I do not know, but Connecticut, Massachusetts, and others.

The CHAIRMAN. Have you indicated to the legislature or otherwise the limitations which you would want to put on that? What type of common stock, for instance.

Mr. WHIPPLE. No; we have not. We have suggested to them that serious study be given to it.

The CHAIRMAN. You would want stability of income just as you do in your revenue bonds and your debentures?

Mr. WHIPPLE. That is right.

The CHAIRMAN. When you invest in the debenture of a large industrial company, what security do you have?

Mr. WHIPPLE. You have the security of stability of earning power, forecast into the future as best you can.

The CHAIRMAN. So that it is based upon your best judgment as to the earning power of the company that issues the debentures?

Mr. WHIPPLE. Of the specific individual company within its sphere as to what you think the opportunities are which it has.

The CHAIRMAN. What proportion of your industrial investments, bonds, and the like, has been invested in debentures of that kind?

Mr. WHIPPLE. I gave that figure, sir.

The CHAIRMAN. I did not notice it.

Mr. WHIPPLE. I gave the reverse figure. It is about 80 percent. Yes, at the end of 1948, 21 percent were secured, so the reverse figure is 79 percent.

The CHAIRMAN. Seventy-nine percent are unsecured on debentures?

Mr. WHIPPLE. That is right, sir.

The CHAIRMAN. There again, that is a pretty substantial indication of the confidence of the finance committee of Mutual in the future earning capacity of the companies which are in the portfolio.

Mr. WHIPPLE. That is what you rely on, Senator, even where you have security. The mortgage on bricks and mortar——

The CHAIRMAN. You do not want to take over the bricks and mortar, if you can help it; is that right?

Mr. WHIPPLE. We did take over some bricks and mortar.

The CHAIRMAN. I know you did, but you do not want to; is that right?

Mr. WHIPPLE. That is right.

The CHAIRMAN. I noticed with a great deal of interest your statement that there is a definite trend away from physical security to stability of earning power.

Mr. WHIPPLE. There appears to be.

The CHAIRMAN. Is that characteristic of the industry as a whole, the life-insurance industry?

Mr. WHIPPLE. To a degree I would say probably so. I have not seen the figures broken down, but from the public offerings that are made of the unsecured debenture type, they have been on the increase and presumably have been purchased by life-insurance and other institutional investors.

The CHAIRMAN. Would you say that the inference could properly be drawn from these two facts—namely, your recommendation that under certain restrictions investment in common stocks should be permitted, and the definite tendency to invest in unsecured debentures—that on the whole you would be encouraging the large company, because it is the large company that does have the stability?

Mr. WHIPPLE. Yes; I think that is a fair analysis, if you mean by the large company the seasoned company, one that has been in business for some years?

The CHAIRMAN. Yes. One of our questions directed to you by the staff had to do with whether or not the investment picture at the present time encourages or tends to encourage and strengthen the mature company.

Mr. WHIPPLE. That is exactly the word I was going to suggest, Senator, the mature company, because there are many mature companies, not too large in size, which have had excellent earning records over time.

The CHAIRMAN. And yet, on the other hand, it must be recognized that if a free-enterprise system is to be maintained we have got to preserve the opportunity for new capital to enter.

Mr. WHIPPLE. That is right, sir; venture capital.

The CHAIRMAN. Venture capital.

Mr. WHIPPLE. Right, sir.

The CHAIRMAN. We have heard a great deal of complaint from New York and other financial centers, on the part of security dealers, upon the part of the stock exchange, and certain investment bankers, that investment capital is drying up. Do you share that opinion?

Mr. WHIPPLE. Investment capital of the type you mention, venture capital?

The CHAIRMAN. Yes.

Mr. WHIPPLE. It looks as though there is some evidence in that direction, Senator.

The CHAIRMAN. What if anything should we do about it?

Mr. WHIPPLE. May I introduce a supplementary statement of a page and a half which I have prepared since my being here?

The CHAIRMAN. Fine.

Mr. WHIPPLE. I have been a very interested spectator at these hearings, as you may know.

The CHAIRMAN. I have been observing you here. Please do.

Mr. WHIPPLE. This is not a blueprint, by any means, but it is a suggestion.

The CHAIRMAN. I am sure your comments upon the testimony that has been adduced to date——

Mr. WHIPPLE. On this particular point.

The CHAIRMAN (continuing). Will be very interesting.

Mr. WHIPPLE. May I read, sir?

The CHAIRMAN. Please do.

Mr. WHIPPLE. The chairman of this committee, Senator O'Mahoney, has several times pointed to current need of small business for long-term capital. At the Wednesday session of this committee, Senator Taft made the point that very often the financing needs of small business can only properly be supplied by equity capital. He also made the further point that the present income-tax laws have made it increasingly difficult for the small-business man to get that capital locally, as he formerly did, and that there is not much prospect of a change in those tax laws.

The problem of financing the needs of small- and medium-sized businesses combines the needs of both debt and equity; and, of course, the two are entertwined, because, without proper equity, it is difficult, if not impossible, to erect sound, desirable loans.

For investing institutions individually to attempt to meet this problem with the high costs and risk elements involved, appears to me difficult, if not impossible. Accordingly, it would seem that one avenue worthy of thorough exploration in an attempt to solve this problem would be to consider the development of some type of organization through which the risks involved may be pooled or shared by many investors.

We would like, therefore, to suggest that the committee and lending institutions both might examine thoroughly the potentialities of the capital-bank proposal made by Dr. A. D. H. Kaplan before this subcommittee in September.

Another example of what I am thinking about is the American Research & Development Corp, mentioned by Congressman Herter on Thursday, which was organized to finance scientific development. Senator Flanders was a founder of this corporation, and a large life-insurance company is one of the stockholders. It may be that organizations of this nature, financed by institutions and other investors, devoted generally to the needs of small business, might be successful in satisfying the requirement for both debt and equity. Thus, the potential borrower or raiser of equity, if deemed worthy, might get his financing in the most appropriate form on reasonable terms.

Conversely, those supplying the capital should be able to obtain a reasonable return on their investment because whatever losses there might be should be more than offset by income and profits. Thus losses and expenses should be absorbed in the over-all picture with much less impact than if individual investment were attempted. Any such venture presumably would have to have some benefit from tax legislation to make its prospects of income sufficiently attractive to absorb cost and losses and still provide a reasonable return.

I should like to emphasize that this is merely a suggestion, since any plan of this kind would have many problems to solve. In order to permit investment in such organizations by life-insurance companies and other investors, many State insurance and other laws might have to be amended. In addition, the desirability of such an investment would have to run the gamut of many authorities, including the boards of directors, finance committees, and officers of investment institutions.

That is just a suggestion, sir. There is nothing particularly novel in it.

The CHAIRMAN. Are we to gather from this statement that, so far as you are concerned, you would not be opposed to capital banks such as Dr. Kaplan suggested to the committee?

Mr. WHIPPLE. We certainly would like to look at it to see if it could not be developed into a form of organization that could be of this type.

The CHAIRMAN. Earlier in the hearing I asked some one of the witnesses—I have forgotten whom it was at the moment—why it is that no insurance corporation has ever been established to insure equity investment. It has seemed to me—in fact, I know the suggestion has been made many times; and, if I remember correctly, the evidence during the TNEC days showed that the proposal was made in Rhode Island to the legislature that a charter should be issued to a corporation, the business of which would be the insuring of business loans. The author of the plan, whose name I have forgotten, seemed to feel that a commission could be charged or rather a premium, which would be less than the fee that is usually charged by an underwriter, who undertakes to float new stock, and that the premium, being less than an underwriter's charge, would be sufficient to establish the reserves out of which losses could be paid, provided of course that careful requirements were laid down with respect to the management capacity of the applicants for the loans.

You have never given that any thought, I take it; is that right?

Mr. WHIPPLE. I have not, sir; no. The financing of such an organization would probably be difficult.

The CHAIRMAN. Yes.

Mr. WHIPPLE. This undoubtedly would be difficult, too, but it seems to afford something for study.

The CHAIRMAN. The reason I bring the matter up is that that illustrates again how the pressures are constantly being built up for the Government to do what private capital will not do.

Mr. WHIPPLE. Has not done.

The CHAIRMAN. Or has not done. You say they will not take the chance; it is difficult to finance it.

Mr. WHIPPLE. That is right.

The CHAIRMAN. And that comes right back to the very problem we are discussing: What to do to create the incentives whereby private capital can be induced to come in.

Mr. WHIPPLE. It seems to me a sharing-of-the-risk plan along the lines of the capital bank would be a desirable thing to look into carefully. It would have a lot of complications.

The CHAIRMAN. Of course, you have not had time to talk with any of the other insurance people about this matter?

Mr. WHIPPLE. No, sir.

The CHAIRMAN. But, of course, living in the insurance industry as you do, could you tell the committee whether you think other insurance executives share this point of view or anything like it?

Mr. WHIPPLE. I cannot, sir; no, because I have not talked about it with them at all.

The CHAIRMAN. Here is another question.

Mr. WHIPPLE. I think it might be well to talk with them about it.

The CHAIRMAN. I do, too.

Mr. WHIPPLE. Yes, sir.

The CHAIRMAN. But I made this suggestion the other day to Mr. Lincoln: When he said that the Metropolitan was very anxious to get the business of small borrowers, I asked him whether he would be willing to cooperate with the local banks, and he immeditely responded to that by saying he thought we were opening a door to a very favorable field and that, so far as Metropolitan was concerned, it would be willing to take 90 percent of any loan meeting the requirements of the insurance company of which the local bank would take 10 percent.

Mr. WHIPPLE. I recall his statement.

The CHAIRMAN. How would Mutual feel about that?

Mr. WHIPPLE. It is a very interesting suggestion, and we are in the same position as the Metropolitan. We are interested and anxious to make loans, regardless of size, but the local loans are difficult to make, as was pointed out. Certainly, bank participation and servicing, if you will, would be a very excellent thing if it could be worked out practically.

As I understand Mr. Lincoln's suggestion, the bank would have to stand by, as he put it—in other words, take a 10-year loan. Did you understand it that way, sir?

The CHAIRMAN. I do not think he gave any special details; but, of course, what we are talking about largely is the long-term loan because short-term money is not so scarce.

Mr. WHIPPLE. It is reasonably readily available.

The CHAIRMAN. The short-term money is not the sort of money that would enable a small business to establish itself in competition with a larger entity.

Mr. WHIPPLE. In some cases that is true. They need permanent capital as well as short-term.

The CHAIRMAN. They need long-term loans more than they need short-term loans, particularly for working capital.

Mr. WHIPPLE. That is right.

The CHAIRMAN. You think that it might be a field in which Mutual would engage?

Mr. WHIPPLE. I would certainly like to have a look at it to see if something could not be worked out. It is an interesting suggestion. We have followed that, of course, to some extent, as you know, and I think Mr. Lincoln pointed out—we have done pretty much the same thing. We have advised our banks throughout the country that we are interested in that kind of loan, and we have done something about them.

The CHAIRMAN. I think, as chairman of this committee, I shall write a letter to the presidents of the companies which have been good enough to testify here and I shall at the same time communicate with the Small Business Advisory Committee and see whether or not we cannot arrange a conference between the insurance companies and the

Small Business Advisory Committee to see whether or not you can work out a participating plan whereby some of this capital, this investment capital arising from the savings of the policyholders, may be made available for sound small-business loans.

Does that sound at all practicable to you, Mr. Whipple?

Mr. WHIPPLE. It does, sir.

The CHAIRMAN. We have made some progress.

Mr. WHIPPLE. I think they certainly ought to work on it.

The CHAIRMAN. Are there some questions?

Mr. SCOLL. Mr. Whipple, in looking over the supplemental statistics, the tables that you filed, on table D, "Acquisitions in 1948, by size of investment units," do you have that there?

Mr. WHIPPLE. Yes, sir.

Mr. SCOLL. According to that table, your acquisitions under $250,000 were 23 acquisitions; over $250,000, there were 111, going up to 10 million and over. There was one 10 million and over, 4 over 5 million, et cetera.

Now, from those figures it appears that the current investments of Mutual are in the larger loans, larger investments, larger unit investments. That is the same as we observed in the case of Metropolitan, and, I believe, also in the case of New York Life. So that it could be said that in the case of the New York companies the evidence seems to indicate pretty conclusively that the New York companies invest for the most part in larger units.

Mr. WHIPPLE. If you confine that to industrial corporate loans, that is true. I think the trend toward the smaller loan has been developing over recent years, as I tried to point out in my statement. It has not arrived at the millennium yet.

Mr. SCOLL. But certainly, as of the end of 1948, most of the industrial and corporate money, of the investments of the insurance companies, was in the larger units.

Now, you say the trend is now going to be——

Mr. WHIPPLE. I do not say the trend is now going to be. I say the trend has been toward those smaller units over time and it is a slow process. How far it will get is questionable because of the cost and loss ratio in the small loan, the cost of acquisition and supervision. Whether or not you could get the thing set up so you can do this thing on individual basis in units of, say, 50 or 75 thousand is a serious question. We have been studying it and trying to see some way to set up that sort of organization, and it may be possible.

Mr. SCOLL. Now, to what extent does this phenomenon of large industrial investments by large insurance companies represent a policy on the part of the company to prefer that type of investment for its available industrial funds? Is it because you find it is easier to do and at cheaper cost to administer, or is there some other reason why you tend to make the larger investments?

Mr. WHIPPLE. It is not necessarily because of the easier manner in which it is done. It is because of the developing economy which is requiring funds in substantial size; it comes to the institutional investment market with the type and kind of obligation that fits into the general investment standard. Even so, new industries, as I have pointed out, have tapped that market as well. Of course, they have been relatively large industries. They started off small at some time.

Mr. SCOLL. It is because the big borrower for the available funds is the one who is looking for the money; is that it?

Mr. WHIPPLE. Certainly in part, I should think.

I might point out one thing, Mr. Scoll: That we do make relatively small loans to business in other categories, as you know, in commercial mortgages, and so on, also in policy loans. A good part of our policy loans go to small business.

You might be interested in knowing that we made a sampling of 2,000 policy loans in 10 agencies a few months ago, through a questionnaire, and admittedly took the larger loans because many of our policy loans are a few hundred dollars. We received 323 replies, or 15 percent, which is not a bad return factor.

Forty-three percent listed business either as the sole purpose or one of the several purposes of the borrowing, which is a higher figure than I really anticipated.

Mr. SCOLL. So that some of these policy loans, then, are definitely borrowings by policyholders to use in their own business; is that right?

Mr. WHIPPLE. From that sampling it would seem so to the extent of 43 percent. That, as I say, is a sampling of the larger loans.

Mr. SCOLL. Of the larger loans?

Mr. WHIPPLE. Yes; $500 up, and that is about the average of all our policy loans—it is about $500. So it is a weighted sampling.

Mr. BUCHANAN. Regarding Government policies, do you care to comment on just what principle should guide the public authorities in the management of the public debt?

Mr. WHIPPLE. Sir, I am afraid that is a pretty big question, that a great deal of discussion and literature has been expended over the years in regard to it, and it gets into the realm of economics; I do not think I can answer the question directly.

Mr. BUCHANAN. You do not care to go into it in any brief thumbnail-sketch way?

Mr. WHIPPLE. I would rather not. It is pretty broad.

Mr. BUCHANAN. I have no further questions.

Mr. KREPS. I have none.

Mr. WHIPPLE. Senator, I have one other statement on the sale and lease-back problem, which I think counsel knows about.

The CHAIRMAN. That sale and lease-back business is most interesting.

Mr. WHIPPLE. I have been asked to discuss the subject of sale and lease-back investment as a part of life-insurance-company investment operations. Before taking up the four specific questions on this subject propounded by the committee, I think it desirable to outline in general terms and very briefly what we consider the main features of a sale and lease-back to be.

The typical sale and lease-back transaction consists of two concurrent steps:

1. A sale by an industrial or commercial company of property to an investor.
2. A net lease of the property by the investor to the seller.

The lease is usually for a long term, ranging generally from 20 to 30 years, although in exceptional cases the term may run for a shorter or longer period than this range. The lease is a net, or, as it is sometimes called, a care-free, lease. Under this type of lease, it is the intent—specifically expressed in the lease—that the rent is to be an absolutely net return to the landlord, free of expense, except for income and franchise taxes and except for taxes imposed upon a transfer of the lessor's estate. Generally the rent is fixed at an amount which will amortize or recoup the purchase price over the term of the lease and yield in addition an income return on the unamortized balance of the purchase price from time to time outstanding. In cases where the term is longer than the anticipated life of the improvements, a recoupment period shorter than the term would be sought. Conversely, in cases where the term is relatively short, some investors, where they feel that there will be a substantial residual value at the end of the term, have taken this into account and have not tried to recoup the entire purchase price during the term of the lease.

Generally the lessee is given the option, or several successive options, to renew the lease at the end of its term at a rental lower than the rental during the fixed term of the lease. It has been our general practice not to provide for options to purchase by the lessee and in no event do we provide for an option to purchase at a nominal price. In a number of our leases we have provided for what is commonly called the rejectable offer. This permits the lessee to propose the purchase of the property after a specified number of years at a price shown in a schedule, computed approximately in conformity with the lessor's unamortized investment plus some additional amount. If the lessor fails to accept the offer within a specified period, the lessee becomes entitled to surrender its lease and the lessor has the property free of the lease.

I shall now discuss the four specific questions asked on this subject.

(*a*) Why was this relatively new form of investment developed?

I want to point out first that actually the sale and lease-back is not a relatively new form of investment, but is merely an outgrowth of a long-standing form of investment which was first opened up to life-insurance companies in many States by liberalization of the insurance laws in the 1940's. Prior to this liberalization of the insurance laws, chain stores had been making net leases for years and it had long been a common practice for an investor to construct a store for a chain under an arrangement for a long-term net lease. The only difference between this and a sale and lease-back is the technical one that in the latter the lessor acquires the property from the owner and then leases it back. Insurance companies and other lenders had long been making first-mortgage loans where the essential element of the security was an assignment of such a long-term net lease.

The first law—outside of special acts passed in Connecticut in the 1880's—permitted life-insurance companies to invest a limited amount in income-producing real estate, other than housing, was passed in Virginia in 1942. No additional laws were then passed until 1946. The New York law, permitting investment of 3 percent of admitted assets in income-producing real property, came in 1946 and the bulk of the laws in other States in 1947.

The main reason for the enactment of these laws was to broaden the field for life-insurance-company investment by recognizing a form of investment theretofore practiced successfully by other investor groups.

Under these new laws, two main types of investments could normally be made:

1. Purchase or construction of property which the insurance company could operate and lease to various tenants under short or relatively short-term leases, with the expectation, under normal conditions, of a relatively high rate of return which the nature of such an operation would entail, and with the hope of appreciation through increasing rentals and higher net return, or through sale of the property.

2. Purchase of property with a view to leasing it to a single tenant for a long term during which the full purchase price could be amortized—in other words, the sale and lease-back. (It is interesting to note in this connection that the Virginia law permitted real-estate investments only where they involved a lease.)

Most of the investments which have been made in income-producing real estate have been of the second type. This has been due largly to the point at which we have been in the real-estate cycle—namely, one of prevailing high prices and costs. Our primary concern in investing funds is necessarily the safety of our principal, and because of the conditions that have prevailed since 1946, we have limited our own investments in income-producing real estate to the second type, where we are assured, through the long-term rental payments of the return of the principal of our investment.

I might also add that investments of this second type are in a field in which insurance companies have had long experience, since, as I pointed out before, insurance companies have long been making first mortgage loans where the essential element of the security was an assignment of a long-term net lease to a chain store.

Coupled with the liberalization of the insurance laws has been an increased use of the net lease transaction by industrial and commercial companies for two purposes—first, as a means of raising additional working capital, and second, for obtaining the use of additional plant or facilities in which to carry on expanded operations. The raising of additional working capital has been accomplished by the sale of existing property and then leasing it back from the purchaser under a long-term net lease. Obtaining the use of additional facilities has been achieved by entering into an agreement with an investor to sell to it the new facilities, upon completion of construction, and concurrently to lease them back under a long-term net lease. Alternatively, the land may be sold to the investor at once and a long-term net lease entered into, with provision being made for reimbursement to the lessee of its reasonable costs of construction.

An alternative to the use of the sale and lease-back would be a debenture or bond issue to provide the working capital or the funds with which to construct the new facilities. Consequently, the use of the sale and lease-back by an industrial or commercial company depended upon whether or not, in its judgment, the advantages, as compared with a debenture or bond issue, outweighed the disadvantages. The main advantages to the corporate lessee are the following four:

1. The principal advantage which the company obtains is the freedom from debt. This advantage goes beyond the usual point made that the company thereby has a clean balance sheet. Because it is in fact free from debt, its future borrowing capacity is greater than if it raised the money by a loan. In reorganization the company may reject the lease and return the property to the investor, in which

event the investor's claim is limited to a maximum of 3 years' rental, whereas the claim of the holder of a debenture or bond is for the entire unpaid principal.

2. The lease does not contain the protective financial covenants—such as restrictions on dividends and retirement of stock, negative pledge clause and restrictions on funded debt—found in debenture and bond issues.

3. The sale and lease-back lends itself more readily to piecemeal and incidental transactions than a debenture or bond issue. This is particularly true where the company is going to build a series of plants or stores. Here the sale and lease-back can be used to synchronize the financing with the company's needs, whereas in a debenture or bond issue, the funds for the entire series are usually all raised in one transaction. So too, the sale and lease-back can be used with advantage for incidental transactions—such as warehouses—where the costs are relatively small.

4. The company obtains as an income-tax deduction the entire rental as compared with deductions for interest on the debentures or bonds plus depreciation on the building. This may give greater income-tax deductions where the land cost is high or where the term of the lease is short.

The principal disadvantages are the following three:

1. The company has to pay a higher return factor than it would have to pay as interest on a debenture or bond issue. Also, after the fixed term, during which the investor's investment is usually fully amortized, the company, if it wishes to continue to use the property, must still pay rental, even though on a reduced basis. If it does not do this, it loses the property.

2. At the end of the period covered by the lease and its renewals, the company will lose the property, unless it repurchases it, and, in that event, would be worse off than in a debenture issue to the extent of the repurchase price.

3. It does not give the company as much flexibility as a debenture or bond issue. In the latter case, an infinite variety of required sinking fund payments may be set up, whereas the rental fixed in a lease is usually a level amount. Also in debenture or bond issues, additional prepayments of principal may be made at any time upon payment of a premium. In addition, provision is often made for an option on the part of the borrower to double the required sinking fund without premium. Such prepayment privileges are not found in leases. If the borrower wanted to dispose of the property, it could sell it at any time or lease it to someone else in the case of most debenture or bond issues, if the property did not constitute a material part of its assets. In any event, it could prepay the loan, even in the case of a bond issue, and then sell the property. In a net lease the lessee is usually permitted to assign the lease but remains bound by the lease. Its only chance to relieve itself of liability on the lease, short of reorganization, would be through negotiation with the lessor or by making a rejectable offer, if the lease contains such a provision.

Furthermore, if a change in Federal income-tax policy should permit property to be depreciated over a shorter period than at present, the assumed income-tax advantage of a net lease could, in cases where the land cost is small and the term of the lease long, turn out to be a tax disadvantage.

From the viewpoint of the investor, there are also advantages and disadvantages in a sale and lease-back as compared with a debenture or bond issue.

The chief advantages which the investor expects are these two:

1. During the fixed term of the lease, the investor obtains a higher rate of return than it does on a debenture or bond issue and recoups the principal of its investment. The rentals it obtains after the fixed term of the lease or the proceeds of any sale of the property after the fixed term are pure extras.

2. It owns a piece of property, whereas a debenture issue is unsecured. If the property is essential to the lessee or has a prime location, or if the rental is lower than the prevailing rent for similar properties, a trustee in reorganization might continue to pay rentals in order to avoid loss of the property, whereas interest and principal payments on a debenture or bond issue might be discontinued or cut down.

The main disadvantages are the following three:

1. The investor has a limited obligation of the lessee instead of a general obligation, as in the case of a debenture or bond issue. It does not have the right to accelerate principal as does the holder of a debenture or a bond and its claim in reorganization is limited to a maximum of 3 years' rent if the lease is rejected.

2. The lease does not contain the protective financial covenants incorporated in a debenture or bond issue.

3. The investor pays income taxes on the excess of the rental over depreciation as compared with income taxes on interest alone on a debenture or bond issue. Thus, additional taxes are paid to the extent that the portion of the rental representing recoupment of principal exceeds depreciation.

Because of the above factors, the investor must give careful weight both to the credit of the company and the value of the real estate. Where the real estate is not prime real estate and readily salable to others, or is not essential to the company, even more stress than usual must be placed on the credit of the company. It is because of the disadvantages I have pointed out that we have adopted the following policy in considering sale and lease-back investments:

1. The lessee must have a very high credit standing—substantially higher than would be required in the case of a debenture or bond with the usual financial covenants. This is particularly true where the property does not have a prime location or is not essential to the company's operations.

2. The rental must be such as would return our investment to us during the term of the lease and in addition yield us a substantially higher rate of return on the unamortized balance of our investment remaining from time to time outstanding than we would receive on a general obligation of the lessee corporation for a like term. As a corollary, all rentals received after the end of the term, whether from renewals of the lease under the option provisions or from a lease to another, must constitute additional return.

(*b*) Describe the form of lease employed, especially in respect to default provisions.

I have already described some of the main provisions of the lease employed in a sale and lease-back transaction, such as:

1. Requirement that the rent be an absolutely net return, free of expense, except for income and franchise taxes and taxes which might be imposed upon a transfer of the lessor's interest.
2. The term.
3. Options to renew.
4. Rejectable offer and options to purchase.

The other provisions of the lease we have used follow in general the form of the net lease which has been in use for years with chain stores and the assignment of which has constituted the essential element of security for many mortgage loans made by insurance companies. Each lease must, of course, be tailored to fit the circumstances of the particular transaction. Also, of course, we have been careful to make the provisions of the lease as tight as possible, because the rental provides no margin for us to incur any expense whatever in connection with the property.

Furthermore, we specifically provide that none of the following shall terminate the lease or entitle the lessee to surrender the premises or to any abatement of or reduction in rent, notwithstanding any present or future law to the contrary:

(*a*) Damage to or destruction of any of the buildings or improvements on the leased premises by fire, the elements, or any other cause whatsoever.

(*b*) Prohibition of the use of the leased premises for any purpose by law, ordinance, injunction, et cetera.

(*c*) Eviction by title paramount.

Since, because of the nature of a net lease, there are virtually no covenants to be fulfilled by the lessor, we have also eliminated clauses which will permit termination of the lease by the lessee upon default by us.

The default provisions usually are similar to those found in shorter term leases. We generally provide that the following events of default entitle us to exercise the remedies provided in the lease:

1. Failure by the lessee to make payment of any installment of rent or any other sum specified in the lease to be paid by it and to cure such default within a specified period after such failure.
2. Failure by the lessee to observe or perform any of its other covenants, agreements, or obligations contained in the lease and to cure such default within a specified period after we have given the lessee written notice specifying such default.
3. Assignment by the lessee for the benefit of its creditors.
4. If the lessee, finally without further possibility of appeal or review—

   (*a*) is adjudicated a bankrupt or insolvent;

   (*b*) has a receiver appointed for all or substantially all of its business or assets on the ground of its insolvency;

   (*c*) has a trustee appointed for it after a petition has been filed for its reorganization.

Such an event of default entitles us, at our election while the event of default shall continue, to terminate the lease upon giving specified notice, to repossess the leased premises, and to recover rents and other sums accrued up to the time of termination, including damages arising out of any breach by the lessee. It has been our experience that provisions for continued liability on the lessees' part after dispossess have been relatively rare. We also have the right, without resuming possession of the premises or terminating the lease, to recover all rents and other sums, including damages, at any time or from time to time accruing under the lease.

(*c*) How do these differ in degree or effect from default provisions such as are ordinarily inserted in debenture agreements?

The default provisions in our net leases, as in leases generally, do not differ materially from those ordinarily inserted in debenture agreements, except as follows:

1. In debenture agreements, there is usually no grace period for defaults in principal payments or in the main covenants of the agreement, particularly the financial covenants.

2. Default provisions with respect to bankruptcy, et cetera, in a debenture agreement usually come into effective operation sooner than similar provisions in a net lease.

As I previously mentioned, debenture agreements also contain financial covenants not incorporated in our net leases and a default in one of these covenants entitles the debenture holder to exercise the remedies contained in the debenture agreement. A net lease, because of its nature, also contains covenants not found in debenture agreements.

The main difference between default provisions in a debenture agreement and a net lease lies in their effect. Upon an event of default in a debenture agreement, the principal and any unpaid interest may be immediately declared due and payable, or as is commonly said, accelerated. An event of default in our form of net lease does not result in an acceleration of the rent but merely gives us the continuing right to collect the rent as it becomes due or the right to terminate the lease and have the property free of the lease. Our only other claim is for rent and other sums accrued to the date of termination and damages arising out of any breach by the lessee prior to the date of termination. Also, as I have previously mentioned, in reorganization the debenture holder has a claim for the entire unpaid principal and accrued interest, whereas the lessor, if the lease is rejected, is limited to a maximum claim of 3 years' rental.

(*d*) Do you regard these sale and lease-back investments as business equities or debt?

We regard these sale and lease-back investments as business equities rather than as debt. A sale and lease-back, such as I have described, is what it purports to be—purchase of property by the investor and a net lease of that property by the investor to the seller. The investor is an owner and lessor of real property and the former owner becomes a lessee. Before we make a sale and lease-back, however, we make the same investigation of the lessee's credit as we do in a debenture or bond issue and actually require, as I have pointed out before, a higher credit standing.

Mr. SCOLL. I noticed you refer to the desirability, or on preferred stocks you say that it is evidence toward the trend of reliance on the stability of earning power as a satisfactory basis for investment. Has the volume of preferred stock offerings generally been on the increase or on the decline in the years since the war?

Mr. WHIPPLE. Definitely on the increase, I would think.

Mr. SCOLL. Now, the emphasis on stability of earning power as a measure of acceptability of investment almost naturally tends to eliminate the new enterprise and the untried investment or venture enterprise; does it not?

Mr. WHIPPLE. Yes; it does. I think we must face that, Mr. Scoll.

Mr. SCOLL. So that except insofar as the new businessman has something to pledge, he gets further and further away from the available channels of investment.

Mr. WHIPPLE. I would not say available channels of investment—from this type of investment, yes.

Mr. SCOLL. So far as the emphasis is on stability, you have to overlook the new man in business.

Mr. WHIPPLE. Pretty much so, unless there is some definitive thing that can be pledged or attached to that thing in the way of a contract or if he has got some property—if you can make a mortgage loan on the property and use that as a basis, with this developing idea of his as a background or backlog to that fundamental security.

There are ways, of course, that it can be done, but they are limited in number.

Mr. BUCHANAN. On the supplemental statement you made, on page 2, benefits from tax legislation to make its prospective income sufficiently attractive to absorb costs and losses—would you care to enlarge on that?

Mr. WHIPPLE. There is no blueprint, but presumably in order to attract investment capital, I do not know that this is so, but it might be necessary to give it some form of tax advantage to attract the necessary capital to go in there for venture capital.

Mr. BUCHANAN. How exhaustive have your studies been so far on discussions of this character?

Mr. WHIPPLE. On this particular point?

Mr. BUCHANAN. Yes.

Mr. WHIPPLE. None at all. I have made no serious study.

Mr. BUCHANAN. In the realm of probability?

Mr. WHIPPLE. No, sir; it is just thrown out as a mere suggestion.

The CHAIRMAN. I was much interested in your discussion of consumer credit. The statement, of course, makes it quite clear that you make these loans to companies which are engaged in that business—in other words, to finance companies.

Mr. WHIPPLE. To finance companies and small loan companies.

The CHAIRMAN. Do you make any supervision of the interest rates which are charged by those finance companies?

Mr. WHIPPLE. No, sir.

The CHAIRMAN. You know, of course, that sometimes those interest rates have been very high.

Mr. WHIPPLE. Yes, that is true, but mainly they are controlled by State legislation, I believe.

The CHAIRMAN. Of course, you are quite right about that, but what I am trying to find out is what discrimination you exercise with respect to the relationship between such a finance company and the small borrower, because if the consumer is exploited, then that investment field can be very quickly destroyed.

Mr. WHIPPLE. Yes, that is right, but we only go into those companies where the State legislation provides for what is accepted as a normal financing charge for the service rendered.

The CHAIRMAN. Now, is there any limitation upon the manner in which a company which would meet your requirements may operate?

Mr. WHIPPLE. I do not quite understand.

The CHAIRMAN. I am still talking about the manner in which the consumer is encouraged to borrow. The consumer could pledge himself way beyond his own personal capacity to pay. Now, you would not allow a borrower from the life insurance company to obtain money beyond its capacity to pay, but some finance companies in the past have done that.

Mr. WHIPPLE. We rely on the management of the finance companies to make the type and kind of loan which would not be beyond the capacity to pay, and going back over their experience in loss, indicating that the management has followed such a policy. It is a management question.

The CHAIRMAN. Is it your judgment that the companies which are now engaged in that form of credit are better managed than they were before the depression? Because one of the reasons for the great collapse in 1929 was the extraordinary extension of credit, including consumer credit.

Mr. WHIPPLE. Yes, I believe they are better managed, from the experience they have had.

The CHAIRMAN. The Federal Reserve Board tells us that consumer credit has been going up.

Mr. WHIPPLE. It has, sir.

The CHAIRMAN. So that any financing by life insurance companies of consumer credit corporations would, I would say, have to guard against the results of the exploitation of the individual.

Mr. WHIPPLE. That is right, sir.

The CHAIRMAN. Any other questions?

Mr. KREPS. In that connection, I want to ask whether the life insurance investment committee had considered cyclical effects of consumer credit financing.

Mr. WHIPPLE. Yes.

Mr. KREPS. It tends on the whole to make inflation worse and tends to make depression worse, because unfortunately the consumers can borrow more money than they should, as the Senator indicated, in periods when everything looks rosy, and are paying up during periods of depression; so that you get an exaggeration of the cyclical swing.

Mr. WHIPPLE. It may be that you get some exaggeration, but I do not think it is the ultimate.

Mr. KREPS. I was wondering whether there was any tendency to try to stabilize that somewhat, say, as the Federal Reserve tried to dampen the amount of consumer credit in periods when consumer demand is already, if anything, high and to increase consumer credit in periods when the country is suffering a paralysis of consumer demand.

In other words, would your policies tend to stabilize consumption demand in the economy or are they oriented in that direction? I was wondering if that possibility had occurred.

Mr. WHIPPLE. Yes, indeed; it has.

Mr. KREPS. That would be very beneficial.

Mr. WHIPPLE. We attempt to confine our loans to those companies which confine themselves in their borrowing to the most conservative policies.

That may be part of the answer, although not the entire answer.

The CHAIRMAN. During the presentation of your testimony I asked a question with respect to the material on page 4, and your associate was going to get the answer to that. In other words, what are the figures with respect to the number of companies in the utility field having borrowings from you with assets over $100,000,000, and the number of companies in the industrial field with assets over $25,000,000?

Mr. WHIPPLE. There are 63 in the utility field, Senator, and 92 in the industrial field.

The CHAIRMAN. How high do they run?

Mr. WHIPPLE. In asset size?

The CHAIRMAN. Yes.

Mr. WHIPPLE. For utilities, the figure is four-billion-odd. You mean the number?

The CHAIRMAN. What is the largest utility?

Mr. WHIPPLE. The largest is 4 billion.

The CHAIRMAN. What is the largest industrial?

Mr. WHIPPLE. The largest industrial is two billion nine.

The CHAIRMAN. I think that is a very interesting statement, showing with respect to the utility use that the number of people using their product has expanded tremendously during the 20-year period.

Mr. WHIPPLE. Yes, sir.

The CHAIRMAN. And the number of people buying the things that industry produces has also grown tremendously during this period. Otherwise, you could not have this growth in the amount of money invested in those fields.

Mr. WHIPPLE. That is right, sir.

The CHAIRMAN. So that it lays particular emphasis upon the necessity for maintaining the purchasing power of the masses of the people, if we are going to have good business.

Mr. WHIPPLE. Yes, sir.

The CHAIRMAN. In other words, it is a pretty good thing to promote security all the way along the line.

Mr. WHIPPLE. That is right, sir.

The CHAIRMAN. Thank you very much, Mr. Whipple.

Mr. WHIPPLE. Thank you, Senator.

The CHAIRMAN. Mr. Whipple, I think you have made a very, very good contribution to the work of the committee by this statement.

Mr. WHIPPLE. Thank you very much.

The CHAIRMAN. The next witness is Mr. Patrick.

STATEMENT OF ROBERT B. PATRICK, FINANCIAL VICE PRESIDENT, BANKERS LIFE CO., DES MOINES, IOWA; ACCOMPANIED BY HOWARD DEAN, FINANCIAL SECRETARY

Mr. PATRICK. I am Robert B. Patrick, financial vice president of the Bankers Life Co., of Des Moines, Iowa. I have been associated with the Bankers Life Co. for approximately 20 years.

My associate here is Mr. Howard Dean, who is financial secretary of the Bankers Life Co. and has been associated with it for practically 15 years.

At the outset I want to say to you that my company appreciates the opportunity of appearing before this committee and presenting the information requested.

I think that, coming as I do, from a great agricultural region, I would be negligent if I did not say that I would like to have seen more questions pertaining to farming and farm lending, as we have prided ourselves for many, many years on having loaned considerable sums of money to agriculture. In fact, in our part of the country we think of our farmers as being a large percentage of our small-business men, and we do a great deal of lending in the Midwest and the Rocky Mountain regions, and in the Southwest.

The CHAIRMAN. Well, Mr. Patrick, I was harboring the idea of inviting you representatives of the small companies to examine the representatives of the big companies, but I thought, perhaps, we might better not adopt that policy.

Mr. PATRICK. I am afraid it would be like the gingham dog and the calico cat.

I have a prepared statement which my associates and I have assembled. It is a long one. It would take me perhaps an hour or longer to read it. If you wish me to I will be very glad to, of course.

The CHAIRMAN. We will be glad to have you summarize it, if you wish, and we will print the whole thing in the record. But at the same time I do not want to minimize your contribution, Mr. Patrick.

Mr. PATRICK. Well, I will do as you wish. I might say that summarizing it would be somewhat difficult. I had rather understood it would be accepted in the record and consequently I have no summary, but I will be delighted to read it all or any part of it.

The CHAIRMAN. Suppose you proceed and we will do the best we can, because I certainly do not want to shut you off.

Mr. PATRICK. The first question pertains to portfolio management in general.

(*a*) If existing restrictions on qualified investments were eliminated entirely, how would you alter the proportions or holdings of your present portfolio?

The services of life insurance are several, but common to all of them is the furnishing of a measure of security to the insured or to his beneficiary. A person with family responsibilities uses life insurance to create an estate in the event of his early death. Older persons and those with no family obligations buy life insurance or purchase pensions to provide income when advanced age curtails productive effort. By electing settlement options, insureds provide that the proceeds of their insurance policies be made available to beneficiaries by periodic payments, thus, relieving beneficiaries from the management and investment of these proceeds. Business enterprises use the investment and other services of life-insurance companies to establish pension plans, to provide life insurance, and to furnish accident, health, and medical benefits to employees. Thus, the funds placed with life-insurance companies are savings that have been accumulated by the savers to assure, partially at least, that the adversities caused by death and disability can be met or that retirement in reasonable comfort will be possible when they are no longer able to produce.

In the investment of funds, the prime concern of a responsible portfolio manager is to carry out the plans of those who create the fund. If a group decided to pool funds for the purpose of speculating for large gain, that group would not be surprised if the manager they selected placed part of those funds in a speculative oil drilling venture, but would not countenance investment of the funds in prime corporate bonds. Undoubtedly, the purposes for which life-insurance funds are accumulated have largely determined the legal restrictions that have been developed over the years concerning the investment of these funds. As a matter of fact, these restrictions are not static but are frequently revised to meet new developments and current needs. Usually, when revisions are made, the opinion of life-insurance management is sought. It would be my opinion, therefore, that the removal of legal restrictions would affect very little the basic philosophy that is behind the investment of life-insurance funds, and, thus, little alteration would occur in the holdings in our portfolio. It would seem that management would be derelict in its obligation if it took the savings of people that were put in life insurance to obtain a measure of security and placed these savings in investments that have inherent in them, either a high risk of loss or the likelihood of wide fluctuation in market value. In fact, life insurance has neither needed nor been permitted by law to build up surpluses that would be necessary if securities that fluctuate greatly were to be purchased.

(*b*) In appraising the possibilities of a new investment item, do you have a minimum amount below which you feel it is impractical or too costly to go? How was this amount arrived at, that is, what considerations determine the figure?

In determining the minimum size of an investment, the real factor involved is the expected net rate of return, that is, the gross rate less all expenses incurred in arranging and carrying the investment. Naturally, some variation can be made in the gross rate paid by the borrower to compensate for high costs, but these costs of investigating, closing, and servicing the loan can be such as to make it inexpedient to consider certain small loans. Probably no general criterion as to minimum size of a loan exists, but the nature of the problem can be best understood by considering several specific types of investments.

It is fairly obvious that an investor, who after careful investigation, has made a loan on a residence located in a certain neighborhood of a city, can make another loan on a residence in a location in that neighborhood without too much additional expense. Much of the information developed in making one loan is transferable to the problem of making the next one. This transference of information also exists, though to perhaps a lesser extent, in making farm loans and loans on general-use business and commercial property. This fact makes it possible to consider mortgage loans as small as $2,500 on farm and residential property and as low as $5,000 on general-use business and commercial property. Mortgage loans on specialized business and commercial property, debenture loans to corporations, or loans to municipalities usually require extensive investigation and study. Very frequently much of this analysis is of such a nature that it is of no great value in considering another loan. For this reason, loans of less than $50,000 can be considered only if some special situation such as the proximity of the borrower to the lender or previous lending experience with the borrower will keep costs low.

(*c*) In appraising the possibilities of a new investment item, do you have a maximum above which you feel it is expedient or too lacking in diversification for acquisition? How was this amount arrived at, that is, what considerations determine the figure?

Adequate diversification is necessary in any sound investment program. The degree of this diversification is largely determined by the extent of the increased risk taken to obtain higher yields than those available on risk-free securities. It is obvious that a portfolio confined to prime bonds would not need the diversification of a portfolio composed largely of low-grade bonds and stocks. Consequently, the maximum amount of an investment in any one issue depends upon the credit of that issuer. To corporations, municipalities and other political subdivisions of States, this amount should not exceed, in our opinion, 1 percent of our assets. To States, the amount would possibly be as high as 2 percent. Of course, in each case the maximum amount would never be reached except for prime credits. At the present time, our maximum single investment item is 0.66 percent of our assets.

II. Fixed interest debt obligations are a traditional media for insurance-company investment.

(*a*) As a regular investor in evidences of debt, what evidences do you see suggesting a shortage of equity capital?

From the data available, there can be little question that in the organized capital markets, proceeds of equity offerings have been a declining portion of total funds raised by business and industry. During the decade of the 1920's, stocks accounted for about 42.5 percent of the total new capital issues, as against 39.5 percent in the 1930's and 26.3 percent in the first 9 years of the 1940's.[1] Also, in 1948 offerings of equity securities were a particularly small part of the new capital raised. It appears from a closer examination of the year-to-year offerings of securities for new money that there has been a strong tendency to swing toward stock offerings in years when the stock market was high or rising, indicating a desire on the part of business management to use the available opportunities to either balance capital structures or avoid debt financing, plus the fact that the only opportunity for raising substantial amounts of equity capital for relatively new and untried industries comes in a strongly advancing stock market. Since the stock market break in the fall of 1946, it has been rather difficult to sell equity securities in the market, until quite recently. There was a considerable decline in the willingness of the market during 1947 and 1948 to absorb preferred stocks of even relatively high-grade names, as is attested by the concessions necessary in dividend rates and the fairly long periods of distribution which were necessary in many cases. This situation has changed quite rapidly in the past few months, however.

As against these indications of a periodic shortage of equity capital, there have been several other avenues available to corporations in addition to straight stock issues. Provision of equity funds through retained earnings has been very large as is clearly shown by the record. Another device which has been used successfully has been the convertible type of obligation. From the standpoint of the size of the operation, the American Telephone & Telegraph Co. has made the greatest use of this method of financing. It is very useful in permitting the company to acquire large amounts of funds at one time at relatively low cost and accomplishes the addition of equity in orderly fashion through conversions.

[1] P. 230, Factors Affecting Volume and Stability of Private Investment.

It seems very probable that an important factor in the decision by corporations as to the method of financing to be used is the cost involved. Based on Securities and Exchange Commission figures, the compensation to distributors of securities in the years 1946, 1947, and 1948 ran at the rate of less than 1 percent of the proceeds of the issue in the case of bonds and between 8 and 10 percent on common stocks. On preferred stocks, the cost ran from 2.8 to 4.5 percent. It is also necessary in this connection to take into account the difference in yields which must be offered to investors. During the 1920's, the annual cash outlay per dollar invested in bonds, preferred stocks, and common stocks in the form of dividends or interest was not much different whereas today the average interest cost is less than half the yield on common stocks and less than 75 percent of the yield on preferred stocks. To this must be added the fact that bond interest is deductible for income-tax purposes while dividends are not.

Let us look at an actual case of a public utility company which needed to raise $10,000,000. I want to emphasize that this is an actual case of a company which recently did raise this amount of money through the sale of bonds and also that earlier in the year they raised funds by the sale of common stock so there are almost no assumptions necessary. It is considered to be a high-grade company and the figures presented are only rounded for convenience. The capitalization prior to the new financing was as follows:

Debt	$55,000,000
Preferred stock	17,000,000
Common and surplus (2,500,000 shares)	29,000,000
Total	101,000,000

The 1948 operating statement was as follows:

Gross revenues	$21,000,000
Net income before deducting Federal income taxes, interest and dividends	7,700,000
Income taxes	2,300,000
Net income before interest and dividends	5,400,000
Interest and preferred dividends	1,500,000
Net income for common stock	3,900,000

The common stock sells in the market at $20 per share and is paying a dividend of $1.20 or exactly 6 percent.

On today's market, the company can sell new bonds in the amount of $10,000,000 at 2¾ percent with enough premium so that the company will receive at least par for the bonds. Thus, the annual cost will be $275,000 or 3.57 percent of net income before income taxes. If common stock were sold at today's market of $20 per share, the compensation to underwriters would be about 5 percent or 1 point. Thus, the company would have to sell approximately 526,000 shares to produce $10,000,000 and on this amount the annual dividend would be $631,200 at the present rate. But the dividend is paid from funds remaining after the payment of income taxes, while bond interest is deductible for income tax purposes. Therefore, to be comparable, we must determine the amount of earnings before taxes which would be needed to produce $631,200 after taxes. This amount, assuming a 38 percent rate of tax is $1,018,000 or 13.22 percent of income before taxes, as compared with the figure of 3.57 percent if bonds are used. Looking at it another way, the difference in cost annually, after deducting income taxes on the part saved, would be $460,000 or over 10 percent of the net income available for common stock in the last fiscal year.

From these considerations, it is probable that the disparity between the proportion of capital raised by stocks today and the figures for earlier years is not all the result of a shortage of equity funds, since management will take the cost into account also.

In discussing a shortage of equity capital, it is necessary in our opinion to establish a criterion of what constitutes a shortage. When an enterprise is new and untried or when the record of operation has been relatively poor, equity money can hardly be expected to be available from outside sources except from those in a position to take long risks with the hope of making large gains. Certainly equity investments with a high degree of risk are not a satisfactory vehicle for institutional investors or for most individual investors. Equity funds for such operations have typically come from owners' savings, members of his family, friends and individual sponsors who have confidence in management and who are in a position to take risks of this character. The amount of funds available from these sources is no doubt less than the amount desired by management in many cases.

Also involved in many instances is the resistance of management to dilution of its equity in the enterprise. Many cases exist wherein the management wishes to retain or acquire the full advantages of the equity position in a company when their available funds are not really sufficient for this. For instance, in "buy outs," the purchaser may attempt to procure a substantial part of the purchase price of the equity stock by placing debt on the acquired corporation. It seems to us, then, that instead of merely a problem of a shortage of equity funds, there are three major questions involved. There are:

(1) Periodic reluctance of the market to absorb equity offerings, except at a substantial discount.

(2) The wide disparity in cost of acquiring new funds by stock issues as against debt or retained earnings, as well as questions of dilution of equity.

(3) Credit problems posed by relatively new and untried businesses, differences in management ability, and all of the other factors bearing upon the question of whether an enterprise will prosper or fail.

(b) For various types of debt securities what ratio of underlying equity do you feel is necessary?

The relationship of equity to debt in lending is relatively of most importance, in our opinion, in those cases where the money advanced is secured by a lien upon a specific piece of property or article which has a value which can be established within relatively narrow limits and which has wide acceptance, or marketability. In this category would fall collateral loans upon marketable securities, warehouse loans upon staple commodities, loans against receivables, etc. In loans of this nature, the criterion of the amount of equity required would be an estimate of the probable fluctuation in value of the security during the life of the loan, and, as an example, in the case of a loan against United States Government securities, an equity of 10 percent would doubtless be adequate, with little or no consideration of other factors necessary.

Moving from the short term type of secured debt into the field of lending upon real estate security, the same basic principles are involved, but other problems are introduced because the term of the loan is usually longer and the market for the security will tend to be more sluggish. Because of these factors, an evaluation of the credit of the borrower will come into the decision as to the amount of equity required. This will be more and more important as the type of property under consideration moves from a standard type which would be useful and desirable to many buyers toward a single purpose property useful to very few. In this type of lending, an equity of 33⅓ percent of the value of the property would probably be adequate for standard types of residential property while an equity of 80 percent might not be enough for a property with little prospect of usefulness to one other than the owner. In other words, when the security is something other than a readily marketable article or property, factors of credit other than the ratio of equity to debt become dominant.

Generally speaking, industries which have typically used a substantial amount of funded debt in financing their needs are those wherein physical plant and equipment are an important part of total assets. This physical plant, however, is usually of limited marketability except to someone who could use it for the purpose for which it was built. Therefore, other factors must be taken into consideration in determining whether or not the ratio of equity to debt is satisfactory. Some of these are as follows:

(1) Stability of income of the company.

(2) Lien position of the debt relative to the total capital structure.

(3) Maturity position of the debt relative to the total capitalization.

(4) Provision for regular amortization of debt.

(5) Relationship between debt service requirements and income.

(6) Strategic value of particular property securing the debt in the operation.

(7) Appraisal of management's ability.

(8) Position of the industry as to growth or decline.

(9) Valuation of assets by the company.

The variables involved are so many that we believe no categorical answer of what constitutes a proper equity/debt ratio can be made. As a very rough generalization, the ranking of industries as to permissible debt ratios would be as follows:

(1) Electric, water and gas utilities.

(2) Telephone utilities.

(3) Railroads.

(4) Manufacturing and merchandising.

In only the first two categories do we feel that the debt ratio as such has much validity, and in these cases the acceptable percentage of equity might vary between 30 and 50 percent of the total capital structure because of other factors. In the last two categories, the factors of income and management overshadow by far the equity to debt ratio.

(*c*) Has there been any change in recent years in the attitude of either business or financial institutions in an acceptable equity/debt ratio?

As was indicated in II (b) the ratio of equity/debt standing by itself is of limited value in many instances. Also, in applying this ratio we believe that it is important to keep firmly in mind that any ratio is only as accurate as the two elements that make it up. Expressed in another way, the ratio of equity to debt is only a function of a ratio of value to debt. After the amount of debt to be incurred is decided upon, this half of the ratio is fixed, but the value portion of it is still free to fluctuate with the level of prices. The determination of values of real estate for mortgage lending purposes which we believe will be reasonably accurate over a period of time sufficient for the protection of the investment is made more difficult by such great changes in the level of prices as have occurred in the recent past. We feel that we must treat the current level of prices cautiously and discount it in arriving at long term values. We have not changed our judgment in recent years as to the ratio of equity-debt in those parts of our lending activities wherein we feel that this ratio is significant, but as indicated above there has been a wider difference between our ideas of value and the market value than existed in prewar years.

In our corporate lending, we are also using the same general standards as in the prewar years. Capitalization ratios of public-utility companies have tended to become more similar as intangible items have been worked out of the balance sheets of those companies where they existed prewar and as the provisions of more modern indentures have taken effect. These changes have brought a larger proportion of the public-utility companies into the conservatively capitalized group and have enlarged the segment of the industry in which we are willing to make investments. The problem of evaluating the effect of price changes on the balance sheets of manufacturing and merchandising companies has been a particularly difficult one, but in our interpretation of balance-sheet ratios we attempt to take into account the effects of future changes in the level of prices.

(*d*) It is sometimes stated that there has been a relative scarcity of corporate bond issues in recent years.

We believe that any discussion of the supply and demand for a particular class of securities, such as corporate bonds, must be prefaced by a quick summary of the basic elements in the total money and credit structure. From the beginning of the easy-money policy in the early 1930's, interest rates dropped steadily with only minor corrections from time to time until our entry into World War II. Total reserves of the banking system rose steadily during the period, and during most of the period excess reserves were very high. This produced a yield curve with very low rates for short-term credit and a rising scale as the maturity moved farther away. When the war-financing period was encountered, this yield curve was frozen in and pegged by Federal Reserve System market operations. Because the necessary reserves were made available to the banking system, the vast amount of war financing was accomplished on this yield curve.

Since the end of the war, the curve has been modified slightly by modest increases in the very short term rates, and in 1946 and again recently the curve has tended to flatten out by reason of increases in prices and consequent reductions in yield on longer-term bonds as easy-money policies were intensified. During the period of very heavy demand for funds in 1947 and 1948, the long end of the curve was again pegged firmly by the Federal Reserve System. We believe that the more confident investors become in the permanence of a supported-yield curve of this type the greater the tendency will be to reach out to the longer maturities for the extra income. This obviously will tend to pull the long-term rate nearer to the short-term rate except in periods of very heavy demand for funds.

We believe that the yield available on United States Government bonds is the primary determining factor of the level of interest rates on all debt securities. As credit factors come into consideration the additional yield demanded for credit risk, of course, increases, but the rates are all related to the yield available on Government bonds. We feel that mention should also be made of the fact that interest rates on mortgages are influenced to a considerable extent by funds made available by the Federal land banks and Federal National Mortgage Association at controlled rates of interest. It is within this closely controlled pattern, therefore, that the different segments of the market operate.

(1) Would you agree?

If by a scarcity is meant a decline in the amount of corporate bonds outstanding as related to the total amount of private and public debt outstanding, we agree that there is a scarcity. The total amount of outstanding long-term corporate bond issues is today a definitely smaller percentage of the total debt obligations of all types outstanding than it has been in the past. In 1929 all term corporate debt constituted 24.8 percent of the total of public and private debt outstanding, including mortgage debt, and in 1939 the same relationship was 24.1 percent. At the end of 1948 total long-term corporate debt outstanding amounted to 11.6 percent of the total of all public and private debt outstanding.[2] Also,, since the amount of long-term corporate debt outstanding has not changed materially over this period and since the amount of funds held by institutional investors has increased very substantially, there has been a steady rise in both the amount and percentage of total outstanding long-term corporate debt held by insurance companies. In 1929 life-insurance companies held about 9.5 percent of total outstanding corporate long-term debt, in 1939 they held about 17.8 percent, and at the end of 1948 held about 37.7.[3] The total percentage of assets of life-insurance companies invested in securities of corporations held fairly steady during the period from 1929 through 1946, but has risen in the past 2 years and is now somewhat higher than in any previous year. The only period in recent years when new issues of corporate debt have been in real supply was during 1947 and 1948, when the total amount of corporate financing was such that it would probably have caused a substantial increase in interest rates on these securities had not the yield curve been tightly pegged.

(2) How does this fit in with an asserted shortage of equity capital?

There is undoubtedly a connection between the indicated scarcity of corporate bonds and the asserted shortage of equity capital. The advantages of equity ownership have not been nearly as well advertised as have the advantages of security and liquidity. This is borne out by the 1949 Survey of Consumer Finances presented in the October 1949 issue of the Federal Reserve Bulletin. In this survey 53

[2] Survey of Current Business, October 1949, table 1, p. 8.

[3] Institute of Life Insurance and Survey of Current Business.

percent of the spending units interviewed were reported as against holding real estate because of their belief that either it was not safe or that a capital loss might be expected, or that they were not familiar with it. Sixty-five percent of the units were unfavorably impressed with the ownership of common stocks for the same reasons. Relatively high percentages of the spending units were in favor of holding savings accounts, savings bonds, and life insurance. Because of the reluctance to take risks, an increased percentage of funds have been channeled into institutional hands and Government securities, rather than into equities, and a greater supply of funds has been competing for the additional yield available from corporate bonds.

(3) Is the scarcity the result of a shift in the situation of corporate borrowers and hence in the absolute amounts available or is it the result of larger funds seeking this type of fixed investment?

We feel that the strong demand for corporate securities is the result of both a shift in the position of corporations and an increase in the amount of funds looking for fixed-interest obligations. Corporations have used internal funds to a very considerable extent for financing capital expenditures, and funds seeking fixed-interest obligations have been large. The total of long-term corporate debt outstanding has not increased in proportion to assets of institutional investors and, as noted above, the percentage of corporate debt in institutional bonds has increased.

These changes, however, in our opinion, are only parts of the overall money and credit situation. So long as funds are freely made available to peg interest rates on the basis of the present yield curve, and so long as investors believe that this will be continued, demand for long-term bonds of all types will be strong. This leads us to the conclusion that the indicated scarcity of long-term bonds of all types, including corporate bonds, is principally the result of the policy of the Government and Federal Reserve System which for some time has been to supply funds in any amount needed to maintain the present pattern of interest rates.

III. Private placements:

(*a*) Are so-called private placements initiated typically by (1) the borrower, (2) an intermediary, (3) the prospective credit? What provisions are made for watching, supervising, or controlling the debtor's use of funds and the subsequent management of the business in the interest of debt service and ultimate repayment?

At the outset, it would be appropriate to define at least loosely the sense in which the term "private placements" is being used. Actually, this term is sufficiently broad to include every offering of securities that is not generally available to investors who typically would be interested in purchasing such securities. Of course, this meaning is too broad, for it would include real-estate loans, short-term bank loans, and small loans to corporations and others that typically have always been arranged privately between the borrower and lender, either with or without an intermediary. The meaning of "private placements" that has developed since the advent of Federal regulation of security transactions is those issues of securities that prior to such regulation usually were offered for sale to the investing public through the facilities of investment bankers. It is in this sense that I am using the term here. When securities are sold publicly, smaller investors are usually able to buy amounts more or less in proportion to the size of their portfolios. However, the typical private placement is too large for a small investor but is not too large for the very big investor or a group composed of a few of them. Thus, the smaller investor participates infrequently in the large private placements. Because of this situation, the experiences of a company our size with private placements may not be sufficiently extensive to be typical. According to our experience, approximately two-thirds of all private placements were initiated by intermediaries and the balance by the borrowers. However, over 80 percent of the private placements of utility-company securities were initiated by intermediaries compared with about 50 percent of those of industrial companies.

Loan agreements used in privately placed loans do not differ in any major respect from those used on similar loans that are sold publicly. Perhaps more loans meeting special requirements of corporations are sold privately; and such loans, of course, require tailor-made agreements. When a loan is made for a special use which would not be made unless the funds were so used, then funds are escrowed or otherwise controlled to assure that they are not used in a manner other than originally contemplated. Construction loans, loans to purchase specific property, or loans to retire existing debt are the most common types of financing in which such arrangements are found. When loan proceeds are controlled in such cases, it is typical for them to be placed with a trustee to be disbursed when the purpose for which the loan was made has been accomplished. There are many provisions used in loan agreements to improve the lender's chance that the loan and interest thereon will be repaid as agreed. Some of these provisions are so common as to be referred to as standard provisions. These are: Debtor to maintain corporate existence; to pay taxes; to permit lender to examine books and property of debtor at reasonable times; to periodically furnish balance sheets and operating statements; to maintain property; to keep property insured; not to merge or consolidate with another corporation except under limiting conditions; and usually in debenture loans the debtor covenants either not to mortgage its property or to secure the lender ratably in the event that it does. Other provisions frequently used are: A restriction against payment of dividends by the debtor in excess of a certain amount. (Usually this amount is limited to earnings after a fixed date. Preceding restriction is sometimes combined with a limit on executive salaries when executives of a corporation are also its stockholders.) Lender is given the right to declare the debt due after notice if working capital falls below a specified amount. (Purpose is to give the lender the right to take steps needed for protection in the case of deteriorating or changing situation.) The issuance of additional debt by the debtor is limited in amount or is made contingent upon the existence of specified earnings and asset ratios. (Purpose is to avoid material change in capitalization ratios.) Debtor is prohibited from or limited in the amount of securities of other corporations that it may purchase. (Purpose is to preclude debtor from becoming an enterprise of an entirely different type or to preclude the removal of assets.) Debtor is required to set up a sinking fund from earnings.

(*b*) Are bonds acquired through direct placement subject to different valuation procedures than those acquired in the market?

The valuation procedure for corporate bonds sold publicly depends essentially on the ratings given such bonds by the recognized rating agencies and on the price for which such bonds sell on the market. For bonds placed privately, there usually is no trading nor are they rated by the recognized agencies. However, the committee on the valuation of securities of the National Association of Insurance Commissioners determines the value to be used for statement purposes in lieu of market value and decides whether the quality of an issue is such that it may be carried in the statement of the insurance company at amortized value based on cost. Essentially, then, there is no difference in the valuation procedure other than that the opinion of the committee on the valuation of securities replaces that of the rating agencies, as to the quality of a bond and that of the market as to its price.

IV. Investment in common stocks:

Bankers Life Co. holds no common stocks at the present time and has never owned any. They are not legal for investment of reserve funds of insurance companies in Iowa nor, as a matter of fact, in New York.

V. Direct investments—particularly in residential or commercial real estate:

(*a*) Does your company now hold the maximum amount of direct real-estate investment permitted under statutory limitations?

No. Under Iowa law, which became effective July 1947, we could have owned as of December 31, 1948, certain types of real estate other than home-office property to the approximate value of $15,000,000. However, the law of Minnesota does not permit investment of more than one-fourth of 1 percent of admitted assets in any single property. This would limit us to an investment of approximately $1,250,000 in one property. On December 31, 1948, we owned three parcels of real estate other than home-office property with an asset value of approximately $680,000. These were acquired under the so-called sale and lease-back premise. Inasmuch as we have felt that the real-estate market was on a very high level since the passage of the enabling legislation by the State of Iowa in 1947, we have not been very interested in acquiring real estate.

(*b*) How are direct investments in real estate valued in making up the balance sheet and computing reserve?

For use in valuation of assets going into the statement of admitted assets, properties are carried at their cost of acquisition less a write-down each year. After analysis of the age and type of the property, the use to which it is put, the degree of surety of income, the period of time over which income is assured, and the legal requirements for accounting and valuing such investments, the net income after payment of all expenses directly attributable to a specific property is divided into two parts: the interest or return on money invested, and the write-down in book value. The New York and Minnesota statutes require that all net income in excess of 4 percent of book value be applied to write-down of book value. If market value can be established with reasonable accuracy, that value is used when it is lower than cost less a reasonable write-down for depreciation.

(*c*) Was the decision to enter the direct-investment field dictated by (1) a search for suitable use of funds; (2) relative attractiveness on an earning basis; (3) desire or need for diversification?

As stated in (*a*) above, we have not been active in purchasing investment real estate. The deciding factor in the purchase of the three properties on a "sale and lease-back" basis was the relative attractiveness of the probable rate of return considered in conjunction with the lack of liquidity of the investment, the credit of the tenant, the term of the lease, the risks inherent in a lease obligation as compared to a debt obligation, the value present and projected of the property, and the risks inherent in real-estate ownership.

VI. Sale and lease-back investment:

(*a*) Why was this relatively new form of investment developed?

Inasmuch as we have not been active in this type of investment, our experience is quite limited. Generally speaking, it would be our opinion that this form of investment was developed by brokers or other intermediaries, for traditionally it is these intermediaries who learn the needs of users of capital and the requirements of the suppliers of it and develop an investment package acceptable to both. It is obvious that the prime requirement in real property for many companies is assurance of continued use; it,. therefore, follows that, if this continued use can be accomplished at favorable cost through long-term lease without capital investment, it is desirable for such a company. If, at the same time, the ownership of the property makes a satisfactory investment medium when measured against the investment requirements of suppliers of capital, then a meeting of minds necessary for a sale has occurred.

(*b*) Describe the form of lease employed, especially in respect to default provisions.

The leases used in the three sale and lease-backs follow generally the standard form of real estate leases. Default provisions in brief are as follows:

1. Should tenant fail to carry out any covenant of lease, landlord may perform and cost of such performance shall be added to rent, and becomes due and payable on the day on which the rent next becomes due.

2. On default by tenant of any covenant, landlord may give 30 days' notice to quit, and tenant shall vacate, but shall remain liable for rent, less the proceeds of rerenting, or landlord without reentering and terminating the lease may sue for all rents accrued and other amounts due.

(*c*) How do these differ in degree or effect from default provisions such as are ordinarily inserted in debenture agreements?

The default provisions of these leases give the landlord the right to sue for accrued rent and other amounts due and permit the landlord to secure possession of the property in order to rerent it and thus minimize the amount that will be owed by the defaulting tenant.

In a debenture loan agreement, the important default provision gives the lender the right to declare the entire debt due and to sue for that amount.

Thus, the right to sue for amounts owing is common to both leases and debenture loan agreements, but the important right of the landlord to repossess the rented property has no counterpart in debenture lending because of the inherent difference between such unsecured lending and property leasing.

(*d*) Do you regard these sale and lease-back investments as business equities or debt?

These three sale and lease-back investments which we have made are strictly equity investments in parcels of real property that are leased under a standard form of long-term lease.

VII. Governmental policies:

(*a*) What can be done by organized efforts of business, financial institutions, or government to obtain the optimum rate of investment and to minimize the variability of gross private investment expenditures?

Our economic policy should be directed toward developing an economy in which the rewards to management, labor, and capital are commensurate with productivity, efficiency, and the element of risk involved in business.

Although the joint committee report on the Factors Affecting Volume and Stability of Private Investment fairly considers the opposing views of economists concerning the most useful procedures to achieve high and effective employment of the factors of production, it also reveals a wide disparity of thought among economists regarding the methods of achieving this objective.

As a businessman I am not qualified to criticize the technical opinions of Lord Keynes, Mr. Hansen, Mr. Moulton, and others whose views on the causes of instability in our system are briefly presented in the subcommittee's report. But as a businessman I have had the opportunity to study the practices of firms, to see the disturbing results of instability, and to recognize the need for an intelligent study of the factors which bring about this condition.

A high level of stability, full employment, and a sound rate of growth are desirable objectives, but I do not know whether we can have them at the same time. In reviewing the investment problem the subcommittee staff has placed considerable emphasis on "the optimum rate of investment." According to the staff of the subcommittee:

> The maintenance of high-level employment requires, however, not only an adequate effective total demand but the maintenance of physical productive capacity sufficient to employ available manpower. It is this second requirement that determines the appropriate level of private investment.
>
> * * * The target for private capital investment, being determined by the need for providing a balanced increase in productive capacity, should be neither too high nor too low. The amount of investment required may or may not be equal to the level of saving at high-level employment.
>
> The problem of readily getting the right volume of investment into the right industries at the right time has thus far not been solved. The price-and-profits mechanism, the policies and plans of profit makers, when cumulated, has not provided stability of private capital investment, nor has the volume of investment been sufficient to provide high-level employment except in periods of war and sporadic or general inflation.

From this it would appear that "the optimum rate of investment" is a strategic variable which, properly employed, could probably bring about a high level of stability, full employment, and a sound rate of growth, simultaneously.

Again, I want to make it clear that I am not technically qualified to decide whether investment or consumption or other factors, either singly or together, will provide the balance that seems so desirable in our economy, but it appears to me that to rely solely on this variable to bring about desirable economic objectives tends to oversimplify problems that are complex. For instance, "the optimum rate of investment" might result in high employment, on the average, but unless the right amount of investment is made every year, in fact probably every quarter, the use of the investment variable alone might create less rather than more stability. As new and more efficient plant is introduced to the system, price and employment instability might result as older productive capacity is withdrawn to meet new competitive situations. In fact, after sober consideration it may be that stability, full employment, expansion, and attendant high consumption are objectives impossible of achievement at one and the same time. I do not mean that we should not strive toward these objectives, but in any event the manipulation of investment expenditures to achieve these goals is only one technique among many. It ignores, for instance, the serious problem of wage and price rigidities resulting from the monopolistic effects of labor and industrial concentration. In one sense growth and full employment, and stability, are contradictory. In a system where full employment and growth are objectives we might have periods of interruption during which plant and equipment and the labor force are idle, as the result of new techniques which periodically produce surpluses of labor and plant. In a stable system growth and technological change might be slower but productive plant and the labor force might be more continuously employed. Whether an "optimum rate of investment" can bring about all these conditions at the same time I do not know.

Another question that disturbs me is whether we can maintain a continuous stream of investment expenditures to employ, in a balanced manner, the factors of production. If the private economy is unable to maintain this stream then the argument is often made that the government should do it. According to Keynes:

> I expect to see the State, which is in a position to calculate the marginal efficiency of capital goods on long views and on the basis of the general social advantage, taking an ever greater responsibility for directly organizing investment.[4]

This implies that the Government is in a position to know not only the volume of investment expenditures to make over consecutive periods to total productive plant and to the subindustries that are components of this plant, but also how to vary the rate of these expenditures from period to period. Assuming that the Government will have this knowledge in the future, would not efficient timing and allocation of investment funds to industries require the closest kind of Government supervision over the activities of private enterprise? Would it not also mean the end of independent decisions by private management?

I do not know the answer to these questions and I doubt whether anyone else knows. In the words of the subcommittee's report, "the doctors differ."

Rather than place our economic future completely in the hands of the Government by giving it control of investment expenditures, I prefer a concerted effort by business and government to bring about stability, a reasonable rate of growth, and high employment. I do not think that we have by any means exhausted the possibility of analysis and study of factors other than investment that may contribute toward instability. For instance, budget and tax policy is one of these factors. Long and careful study by business and government should

[4] The General Theory of Employment, Interest, and Money, 1936, p. 164.

be undertaken to reach definite conclusions as to whether reforms in this area should be made. In current discussions of budget policy and proposals for reform the general arguments seem to fall into three main groups. First, there are those who emphatically support an annually balanced budget in prosperity and depression. Second, there are those who discount completely the importance of balancing the budget at all and argue that in an expanding economy, economic policy should be directed toward increasing Government expenditures to maximize national income. This group maintains that rapid growth of national income produces a volume of tax revenues that will automatically balance Government expenditures. The weakness of this argument is that there will always be groups in government and outside who will support the need for expensive projects at home and abroad. Under this approach expenditures will gain in size and momentum and will always exceed tax revenues no matter what the size of national income. Third, there are those who argue for a stable budget that bears a close relation to the basic needs of a private economy and its future growth.

It is this third proposal that seems to offer some possibility. In periods of high national income and high employment, such as the present, the stable budget would be limited to what must be done, such as expenditures for military security, carrying charges on the debt, and other obligations. Under a stable budget new programs in the field of housing, resource development, agriculture, and so on, would not be undertaken during periods of inflation. Furthermore, programs of this kind would not be undertaken at any time without a most careful study of their long-run costs and effects on private incentive and the efficiency of management and labor. If programs of this nature are found to be essential to stability then they should be undertaken by increasing tax rates immediately to provide for their costs. Only in this way will taxpayers know whether programs that appear to be socially desirable are worth their cost in increased taxes. When the budget is stabilized we should review our tax structure and determine whether our tax policy encourages or discourages private investment. When this has been done and when changes have been made in tax rates they, too, should be stabilized to produce a surplus of revenues during periods of prosperity. During periods of moderate recession, tax rates should not be changed; but during depression, particularly if it is severe, tax reductions might be desirable.

A stable budget and stable tax rates set to incur surpluses in prosperity to offset deficits in depression might favorably influence business expectations by creating stability in two vitally important fields, budget and tax policy. Such a policy might enable us to guess with reasonable accuracy the size of surpluses or deficits resulting from projected levels of national income. I believe that long-range planning can be more effectively carried out in the Government and private sectors under a stable budget and stable tax rates than under the present system of unpredictable budgets and deficits. In such a climate the combined efforts of business, financial institutions, and Government could take a step forward to achieve over-all stability and high employment.

The CHAIRMAN. May I interrupt you there, Mr. Patrick?

I think this is a very thoughtful answer to the question asked in the questionnaire.

What is your definition of a stable budget?

Mr. PATRICK. I think a stable budget would be one which was set on a basis of the agreed need of a period which would be considered to be a fairly normal period. Certainly a stable budget, in my opinion, would not be a budget which used up the entire tax revenue during a period of unprecedented business boom.

I feel that we must develop sufficient income during the boom period to at least provide surpluses, which could be applied to debt retirement in order to be in a better position to possibly issue debt to fund a deficit created during a period of depression.

The CHAIRMAN. In other words, during a period of prosperity the tax revenue should be sufficient to store up a surplus to reduce the debt, so that in case of a recession or a depression there will be ample opportunity to incur debt to meet those conditions?

Mr. PATRICK. I feel that we should certainly trend in that direction.

The CHAIRMAN. And when you speak of the present unpredictable budgets and deficits, I assume you realize that there are few prophets in business and perhaps not many in government. You cannot tell for a few months ahead in the present conditions of the world precisely what the Government has got to do.

Mr. PATRICK. I think that is true in some fields.

I heard you yesterday very ably state the needs of the country and the pressures to meet those needs which were put upon legislatures, and I assure you that I realize that the pressure must be terrific, to approve expenditures of one type or another.

However, Senator, to satisfy these needs means that they all have to be paid for one way or another. Now we either pay for them today by increasing taxes, or, if we do not pay for them today, then they must either be paid for by succeeding generations or in effect by inflation.

The CHAIRMAN. You are just as right as you can be.

Now take the condition that existed in Congress 8 years ago, just after the Pearl Harbor disaster. We were declaring war; the whole country supported that declaration. Then the Congress was confronted with the problem of how to finance the war, and there was a long discussion: What proportion of this cost is to be borne by taxation and what proportion is to be borne by borrowing against the future?

There were many arguments for a low rate of taxation and a high rate of borrowing, or, conversely, a high rate of taxation and a low rate of borrowing. But finally, because a decision had to be made, the tax law was modified and tremendously increased, but not enough by any means to make it possible to forego tremendous borrowing.

Mr. PATRICK. Well, I do not believe that we are going to get any kind of an answer by considering a war period. Obviously, during a war period we have to operate in a way which gives us the best opportunity of succeeding in the undertaking of the moment.

Now we have a lot of programs which cost tremendous sums of money which are not connected with the war at all, and it is to that realm that I refer.

The CHAIRMAN. I am glad you brought that up, because I just wanted to carry that analysis just a step further.

Now it is true that we are not engaged in an active war, but it is also true that we are engaged in cold war, and that cold war puts it up to the Government to decide whether or not it will make expenditures which are designed, for example, to contain communism.

Mr. PATRICK. Of course, but for me it is a little harder to always evaluate the needs in the cold war.

The CHAIRMAN. It is for us.

Mr. PATRICK. They are different. They are based more upon opinions which I, as a layman, have difficulty in evaluating.

When we are attacked and in actual war, I can understand our needs. It is a little harder for me to understand them when in a cold war, but that is still military, and still we are trying to protect ourselves. I was thinking about the programs, you understand, in a realm in which I think we have more discretion. I do not believe we have any discretion about war, we have got to protect ourselves. I just could not take any other point of view.

The CHAIRMAN. Of course; that is what I thought.

Our uncertainty—when I speak of "uncertainties" I mean the uncertainties of the people in Congress—are just as great as yours.

Take, for example, the problem of whether or not we should appropriate the money that is necessary to arm the nations of western Europe under the Atlantic Pact.

Well, finally Congress decided that that should be done. And it is what we call a bipartisan policy; that is to say, there was no partisan division about it. There was division, of course. Some people said, "You shan't do that; you should not do it at all."

But the majority opinion, not only in Congress but in the public, seemed finally to agree that that was a cheaper way of defending ourselves and obtaining eventual world peace than by abandoning the field to communism.

So much for those problems involved, or the expenditures involved, in national defense and international policy.

Now come to this other field of domestic expenditure. I think it is often overlooked that inflation takes its toll out of the Government purchases just as it does out of the purchases of the individual. The Government pays a good deal more for steel now, steel that is necessary in the Army and in the Navy, than it did 10 years ago. And if we are to judge the accuracy of the reports in the current issue of Iron Age, the steel industry is planning to up the price of steel again. That means increasing the cost of Government purchases.

Mr. PATRICK. I presume their costs have gone up, have they?

The CHAIRMAN. Well, I suppose that will be the argument offered in justification. I am just citing the fact.

Now my recollection is that the cost of things that the Government has had to purchase this current year is at least 40 to 50 percent greater than it was a few years ago.

Mr. PATRICK. I am satisfied that Government does not get anything cheaper. I think they have to pay for it.

The CHAIRMAN. That is right. But then we have problems of expenditure.

Now, what about flood control? The demand comes to Congress from those areas through which great rivers flow, and the argument is made: Unless we control these floods existing property values will be destroyed. So the congressional committees that study that problem are confronted with a judgment, difficult judgment, whether we are to permit these properties to continue to be destroyed by floods when they are capable of being controlled.

Then there is the case of rivers and harbors. With respect to flood control, I might be permitted to point out a little difference between the way we finance flood control on the one hand, and reclamation on the other. In our arid-land States, when we put water on the land we make the farmer pay back a substantial part of it. But in the States which are visited by floods, we take the water off the land and we do not charge the farmer whose land is relieved from floods a bit for that.

Mr. PATRICK. He frequently suffers, at least in our part of the country, such great loss due to a flood he pays for it without being assessed.

The CHAIRMAN. I thought I would get the Bankers Life on that side before I got through. So, you see, there are these problems of domestic expenditures.

Mr. PATRICK. You are speaking pretty much of emergency matters. It would seem to me there must be some expenditures that are discretionary, Senator.

The CHAIRMAN. Well; I think actually that the expenditures which go for the normal civilian activities of government are so small in comparison with the general expenditures that you could repeal them all and not make a dent in the budget.

For example, you could absolutely repeal every dollar that is appropriated for Congress——

Mr. PATRICK. I am not in favor of that.

The CHAIRMAN (continuing). Every dollar appropriated for all the United States courts, and you would not make a dent upon the expenditure. You could close every Federal court in the State of Iowa and throughout the United States, and it would not mean anything in the reduction of the interest upon the national debt.

Mr. PATRICK. You understand I would not advocate that for a moment, do you not?

The CHAIRMAN. No; of course you would not. I know that.

But what I am primarily pointing out is that this cry for cutting expenditures is always accompanied by the statement: "Why, of course, we do not want to cut national defense, not at all. But we want to stop these other wastes."

Now, I would like to see the people show us where these other wastes are.

Mr. PATRICK. Senator, I am not an economist, and I do not want to try to take position of an economist, but the idea has appealed to me somewhat that some of these programs which are being undertaken today, of whatever magnitude—many of them must be of considerable magnitude—are not justified under existing conditions.

Mr. SCOLL. Which ones?

Mr. PATRICK. Well, take in the realm of housing, for example.

The CHAIRMAN. Let's get into one of the big ones. How about the farm problem? What are we going to do with that? I want to talk to your Iowa constituents.

Mr. PATRICK. I want to know more what you consider the farm problem to be.

The CHAIRMAN. What I consider it to be?

Mr. Buchanan. Stable farm prices.

The Chairman. That is right.

The farm problem has been with us for a generation ever since World War I. And during World War II, as a deliberate Government policy, we undertook to ask the farmer to produce great quantities of food because we needed that food as a commodity for war. We needed it not only to feed our own armed forces, but we needed it to ship to our allies. So we said to the farmer: "Now you produce the good and we will guarantee you that for a period after the war you are not going to have a sudden drop of farm prices because you have got a tremendous surplus."

So that it was part of the contract that Congress made with the farmer that he could be assured the ground would not be cut from under him so far as his farm market was concerned. Now that is the thing that made necessary the operation of the Commodity Credit Corporation. Now we can violate that contract. Congress, of course, is trying to find a way——

Mr. Patrick. Senator, excuse me. Considering, perhaps from a broader aspect than that, I realize there was a contract of sorts there. And I want it clearly understood that we must have in this country a very sound agriculture. We cannot have conditions that existed in 1932; I recognize that.

Now whether a farmer needs to be assured of a price as high as the one today, I rather question. Of course, he wants to be and, as a matter of fact, I, too, would like to know that I did not have any risks tomorrow. But whether the country can give such assurance and whether they can afford to do it, I have some serious question.

Already surpluses have piled up of one type or another which have actually had to be destroyed. I mean things have been raised and they have not contributed anything to our society.

The Chairman. That is right.

Mr. Patrick. I know that you know that. I want to make a very moderate statement about it. That is wasteful, and the people where I come from are not used to waste. You talk to a good Iowa farmer and he considers that to be—it is like when they killed the little pigs. Farmers did not like the idea of killing little pigs. People were hungry and they had raised theirs.

Mr. Buchanan. But what are we going to do about the farm surplus problem?

Mr. Patrick. I think if we did not have guaranteed prices as high as they are we might not have marginal land in production to the extent we have. Already several irrigated sections have reduced the water table by irrigation to the extent we have a serious situation. I do not believe that some of that irrigation would ever have been done if we had not had those prices.

Mr. Scoll. What irrigation? Where are you referring to?

Mr. Patrick. Some areas in the Southwest.

There is a Federal Reserve bulletin—I believe but I cannot quote you exactly—stating that the situation in the high plains area in Texas is a very serious one. We are very interested in that because we have loaned a good deal of money throughout Texas and throughout the high plains area.

Now I am not qualified enough to discuss that with you intelligently. But I can refer you to the bulletin of the Dallas Reserve Bank which I presume to be a very competent study.

Much of that area I do not believe would be in production, in answer to your question, sir, if they did not have the assurance they were going to get high prices.

Mr. BUCHANAN. What about your home State? Has there been any increase in production in the State of Iowa?

Mr. PATRICK. That, I presume, is pretty much a statistical question. Iowa is by no means a marginal agricultural land, and consequently I do not believe there has been any material change in the amount of land in production in Iowa.

Mr. BUCHANAN. But there has been an increase in production, though?

Mr. PATRICK. I think that is probably due to technological development, sir.

Mr. BUCHANAN. It all adds up to the surplus and the problem.

Mr. PATRICK. Yes; I agree with you.

Mr. BUCHANAN. That we have to deal with.

Mr. PATRICK. I agree it all adds up to the problem, but I think there is a question about whether we can continue to assure prices as high as at present to agriculture.

The CHAIRMAN. On that very point, Mr. Patrick, I can assure you that where the Bureau of Reclamation operates and brings arid land into cultivation by putting water upon the land the result has been not only the settlement of farms but the building of towns and the building up of revenues, and the raising of crops which have had a ready market, which in a single year have sometimes amounted in value to the cost of the project itself.

But that is neither here nor there.

Mr. PATRICK. You understand I am not making any broad condemnation.

The CHAIRMAN. I understand that perfectly. And I was about to say that this is scarcely the forum in which to discuss the farm policy. But I do want to say to you that these points you mention, of course, are well understood in Congress, and there is a debate. The debate goes on: Shall we do it this way or shall we do it that way?

Of course, we ought to reduce surpluses. We should not destroy surpluses. But how to do it is the problem.

Now we have a suggestion made by Secretary Brannan that the way to prevent surpluses from growing up and destroying the agricultural economy is to maintain a low price to the consumer, thereby making it possible for the farmer to sell all that he produces, and then let the Government take up the slack.

Now I confess to you, as far as I am concerned, I am not ready to say that that is an answer. But I call your attention to the fact that the purpose of the proposal is to remove the surpluses, and the contention of the farm organizations and of the Secretary who support the proposal is that it would be vastly less expensive to the taxpayer than the program which we have. And the present law, of course, was headed toward a gradual decline.

Now the alternative to having a farm program of some kind is to have no program of any kind, and then we go back to 1932, which is the situation that nobody wants to have restored.

Mr. PATRICK. You are jumping pretty fast there—are you not?—from either this kind of program to no program at all.

The CHAIRMAN. I did not say that. I did not say from this kind of program.

Mr. PATRICK. Maybe I misunderstood you.

The CHAIRMAN. You did. I said, "Here is the argument between the program we have and the program that is proposed."

And I say the alternative is between a program of some sort—I do not say what it shall bé eventually—or no program at all.

Mr. PATRICK. I am very much in favor of agriculture being given very thoughtful consideration, sir; I would not leave any other impression with you.

However, those costs are large; they have to be paid for, and they take their toll. And I am afraid they may take it through inflation, as you have adequately stated.

The CHAIRMAN. All of this leads up in my mind to this question so far as your suggestions are concerned. You are discussing the general situation?

Mr. PATRICK. That is right.

The CHAIRMAN. And the desirable program of investment, of Government budgetary policy, and tax policy, without respect to the emergencies. You acknowledge that if there is an emergency——

Mr. PATRICK. I do right in my paper say that.

The CHAIRMAN. You see what I am trying to guard against is these headlines which do not always take into consideration these qualifications, sir.

Mr. PATRICK. Of course, we might not always agree what an emergency is, either.

The CHAIRMAN. That is true; that is true.

Mr. SCOLL. I would like to pursue with you a little bit further your definition of a stable budget. Presumably a stable budget would not necessarily be a balanced budget.

Mr. PATRICK. That is right.

Mr. SCOLL. So, would it mean a managed deficit? Is that what you have in mind?

Mr. PATRICK. I am not sure I know what you mean by a managed deficit.

Mr. SCOLL. Well, if the budget is unbalanced, there is a deficit. Now, how would you achieve a stable budget? Since it is not a balanced budget, what is a stable budget? Is it an unbalanced budget, predictable or managed?

Mr. PATRICK. I am not an economist nor a statistician. In fact, I have some claim to being a statistician, maybe, but not to being an economist. I could refer you to the report of the CED. Their concept of a stable budget is reasonably close to my concept.

Mr. SCOLL. That is the concept you have in mind?

Mr. PATRICK. Yes; I think the concept in their recent report would be close to what I have in mind as being a stable budget. Now, I am not an economist, and I am not competent to discuss thoroughly with you.

Mr. SCOLL. Do not be so modest. Your statement indicates you are fully competent to discuss this matter.

I would just like to get a little clearer picture from you of what you think the budgets would be like in any given period which would be stable enough to encourage the confidence of private investors. Have you thought it through that far?

Mr. PATRICK. You mean what would be the actual level of a stable budget described in what—in terms of percent of national income? I am not sure that I understand what you want.

Mr. SCOLL. I am trying to find out what you mean by a stable budget.

Mr. PATRICK. Well, stable, I think, is rather self-explanatory in that it does not change greatly from year to year; and that I anticipate under that there would be reasonably stable tax rates which would not change, but the amount that would be realized under them would vary, depending upon the national income. I do not anticipate that we would spend all of the revenue which is obtained from taxation in periods such as we have at the present time and would probably spend more in depressed periods.

Mr. SCOLL. You were talking about the long-term aspect?

Mr. PATRICK. Certainly.

Mr. SCOLL. And I am talking about the short-term aspect, say, 5 years. Take the next 5 years. What would a stable budget be like for the Federal Government, say, in the period from 1950 to 1955?

Mr. PATRICK. Well, it would be a budget in which services that the Government was going to perform during that period—you understand, it is not given to me to foresee what it is going to be like from 1950 to 1955. But it would be a budget based upon the services which the Legislature had very competently determined the country needed.

The CHAIRMAN. Well, it is proper to say that was the theory upon which the Congressional Reorganization Act was passed by the Seventy-ninth Congress. It was provided there that there should be a legislative budget; that is to say, after the executive budget had been submitted to Congress, then the Legislature—that is, the Congress—should determine how much was to be expended. That having been determined, if the revenue of the Government was not sufficient, Congress would have to make a determination whether to raise the excess by way of taxation or to reduce the expenditures. But it just happened that the thing did not work out because we live in a dynamic world, and we had not yet gotten the international affairs settled. So it is just an impossible thing in times like these for any fiscal officials to sit down and say, "Well, now, over the next 12 months this is all we will have to spend."

That was illustrated by what I said yesterday about the expenditures for atomic energy. We decided to put a restraint on those expenditures. Then something happened way in the middle of Russia and we decided to take off those restrictions.

Mr. PATRICK. I think there are bound to be unpredictable situations in the nature of severe emergencies arising. Now, what distresses me about that in terms of planning and in terms of an optimum rate of investment is the fact that when those arise they have an impact upon our economy. And then this concept of stability through varying investments is certainly very difficult to achieve. Now that is a kind of layman's point of view. I am not sure I see everything involved in it, either.

The CHAIRMAN. Well, I think you are doing pretty well, may I say, Mr. Patrick.

Mr. PATRICK. Well, you are generous, sir.

The CHAIRMAN. Mr. Kreps?

Mr. KREPS. I have one or two questions.

I would like to get a little more guidance on what you mean by stable levels of the budget. And I must confess I am not quite clear. I understand the CED proposal and Beardsley Ruml's and others tie to gross national products fundamentally.

Taking a level of gross national product as of $250,000,000,000, would you say in excess of that we ought to be balancing the governmental budget whatever it might be?

Mr. PATRICK. Sir, I do not think I am competent to set a level. Actually, I merely want to talk in terms of some limits.

Now, obviously, to take the level that existed in a depressed situation in the early thirties would not be right. It would be too low to take that level to set a budget. I feel with equal conviction that to pick a level such as has existed in the last few years, which has been the periods of greatest business activity we have ever known, would be equally wrong, and further to assume we were going to have a continuation of that. We may have, and as a matter of fact I hope we do, but history does not indicate that things have worked that way.

Mr. KREPS. In answer to the questions of the chairman as to out of what funds the budget would have to be met, the reply was either deficit or inflation. Is not there a third, namely, out of the growth of the country, out of the growth of national income? Does it not make sense to develop areas of the West, for example, and, as the Senator implied, go into debt at the present time in order to get the increased production and economic preparedness that comes with the development of the West?

Mr. PATRICK. I would stand corrected on that statement. There is no doubt but what growth would be able to pay for some.

The CHAIRMAN. I do not want Dr. Kreps to put anything into my mouth. I did not want to advocate going into debt to do these things. In fact, I just pointed out, so far as western reclamation is concerned, the money that is appropriated for that purpose produces a return to the Government.

I believe in productive expenditures. I believe that investment of Government funds in helping to expand the economy will produce returns both for business and for the Government, and I think the record substantiates that.

I believe that Government by a wise tax policy particularly designed to provide incentives for the investment of private funds can help to expand the economy. And that is why I have been so interested in this investment hearing. The point of it is not to build up a case for Government investment per se; the point, as I see it, is to find ways and means of promoting private investment in the expansion of our economy.

Mr. PATRICK. I understood that.

The CHAIRMAN. Now, whether private expansion, private investment, will be sufficient to enable us to maintain the national income or the gross national product at a sufficiently high level to enable us to continue to pay the interest upon the national debt, that is another question. And I think the payment of the interest upon the national debt is a problem of primary consideration. We must not permit the national income to fall; because, if we do, we will destroy the capacity of the Government to pay the interest on the national debt.

Do you agree with that?

Mr. PATRICK. Obviously, sir. There can be no argument with that.

You are doing awfully well at picking out the musts in the budget. I still think there are some discretionary things.

Mr. KREPS. You are probably familiar with the publication of this committee which shows the total of all so-called welfare payments, net cost to the Government, is about $1,700,000. Those are the last figures. Which means, therefore, that the economies would have to be made, as the Senators suggests, in these items you have regarded as pretty hard to reduce—war and war-connected expenditures.

Mr. PATRICK. I believe that the Senator said yesterday the war budget and war-connected was about 76 percent.

Mr. KREPS. That is right.

Mr. PATRICK. And I have not a picture before me in my mind exactly of how the budget is made up. But I do believe there are discretionary things in the budget that possibly in a high period like this might be curtailed. I think it would be in the interests of the economy if they were curtailed during this particular period.

Mr. KREPS. Now someone who comes from one of these Southwest States—I suppose anybody from California always has to speak for California.

Mr. PATRICK. They usually do, and Texans do for Texas, too.

Mr. KREPS. We are impressed when we look at these expenditures with the fact that most of the irrigated lands that we have raised crops, fruits, vegetables, other crops that do not enjoy the kind of support or the amount of support which we find goes for crops which are raised in Iowa, such as corn and wheat and certain crops in the South. Therefore we do not see this problem in terms of marginal lands out our way, but in terms of marginal lands in the Middle West and probably in the South, that are not under irrigation. We have the vitamin-producing foods.

Mr. PATRICK. I would not want to get into any kind of a regional discussion.

The CHAIRMAN. Doctor, let's have somebody bring in the California flag and you can stand up and wave it.

Mr. KREPS. Does not this problem go far deeper than you have indicated?

Mr. PATRICK. It is not a simple problem, sir. I would not want to leave anybody with the impression I think it is a simple problem. It is dreadfully complex and I know it.

Mr. KREPS. That is right.

The CHAIRMAN. Will you proceed with your statement, Mr. Patrick?

Mr. PATRICK. (*b*) Does your company have any program for timing direct investments or the purchase of other securities, or is the time controlled solely by the flow of funds?

I assume that by timing is meant a discontinuous investment of funds over the business cycle. I also assume that timing implies contra-cyclical investment action and that by direct investments is meant expenditures resulting in the creation of capital goods.

Depending on the investment outlook and yield patterns my company shifts its emphasis from one type of security to another and in this sense we time our investments. However, we cannot delay investments by holding funds idly for investment at a later date. We are always under the pressure of the inflow of funds, particularly during periods of high personal income when savings are high and we would suffer serious loss of income if these funds were not continuously invested.

Since July 1947 we have had legal authority to make direct investments in urban land and to erect income-producing improvements thereon. Under this authority our investments have been small because of currently inflated costs. When the market is more favorable we will probably increase these investments. To this extent we expect to time our direct investments contra-cyclically.

While this is the only kind of direct investment we may make, we play an important role in the creation of direct investments when we advance funds through our mortgage-lending activities to those who do undertake construction programs. Investments of this kind are not made contra-cyclically. In fact, it would be impossible to time these investments contra-cyclically because the building boom augmented by Government housing programs of the past few years has followed a cyclical rather than contra-cyclical pattern, creating a wide market for this type of investment at the peak of the boom. During inflation and full employment the Government has sponsored and encouraged residential construction through the FHA, FNMA, and VA. These programs have not lessened inflationary forces and in no sense have been contra-cyclical as the FHA program was in the thirties. Insurance companies have aided these programs greatly by investing a substantial proportion of their increased premium income in housing, but these investments in the postwar years have been with the cycle rather than against it.

As personal income decreases during depression, savings through insurance decrease and the amount of funds available for investment by insurance companies is less and the demands for policy loans increase. These demands are based on contractual obligations and must be met. However, although our income available for investment is less, we undoubtedly contribute to contra-cyclical action by making funds available during depression through policy loans and withdrawal of cash values which undoubtedly have a contra-cyclical effect on the economy by increasing the supply of funds available for consumption expenditures during depression. Some of these funds, probably only a small percent of the total, are used for investment. The importance of policy loans as a contra-cyclical factor was not inconsiderable during the decade of the thirties. For the period 1930–39 approximately $3.4 billion was outstanding on the average compared with $1.5 billion outstanding on the average between 1920–29.

(*c*) Having in mind for the moment the problem of variability rather than the amount of investment, are there any Government programs which you feel contribute specifically to such variability? Are there any programs which might be adopted to minimize the instability of private investment?

I assume that you want me to comment on Government programs that contribute to instability and to inflation.

As the last war approached its end, private and Government economists and businessmen generally took the view that a sharp depression would follow with heavy unemployment. The fact that depression did not occur was the result of a tremendous volume of effective pent-up demand for consumption goods. Furthermore, the boom was supported by the heavy expenditures of business on new plant and equipment which had been deferred because of the war. It is impossible to say how long the high levels of income and employment of the immediate postwar years would have continued if the factors of deferred demand alone had been permitted to operate. Whether the boom would have been short-lived we have no way of knowing but the fact remains that the economy did make a speedy reconversion and go on to an unprecedented period of prosperity. The inflationary pressures that developed were certainly intensified by postwar Government programs. In mentioning these programs I do so without implying approval or disapproval of their social desirability. In the comments I am making I am restricting myself solely to what I believe to have been the undesirable economic effects of these policies.

The maintenance of low interest rates during the boom was inflationary, in my opinion. In making this statement I do so with the full understanding that moderate increases in the interest rate will not alone check an inflationary boom. But, nevertheless, I believe that easy money contributed its share to inflation. The Government also encouraged by credit guaranties and other means vast residential housing programs at a time when labor and materials were scarce. This did much to raise the cost of housing to unprecedented levels. This program was directly inflationary. The atomic energy program which could not be`postponed also contributed its share to inflation. The payment of veterans' benefits, the Marshall plan, and the reduction of income taxes also fed inflation. Since the committee has placed so much emphasis on the desirability of good timing it is appropriate to mention that contra-cyclical timing has not been followed by the Federal Government in the postwar years. The committee should understand that in referring to these Government programs which I believe contributed to variability I do so with the realization that the payment of veterans' benefits may have been necessary, that the housing programs may have been justified in part, and that it was essential that we meet our international commitments, and make heavy expenditures on security and atomic energy. Nevertheless, these programs did contribute to inflation and in themselves show the great difficulty in timing and planning investments.

If timing is a virtue then a deferment or a limitation on certain of the programs of recent years might have contributed to minimizing the instability of private investment in the future.

If we are to minimize the instability of private investment it seems to me that a climate favorable to business expectations and risk-taking should be created. In my answer to question VII (a) I briefly outlined the importance of a stable budegt and tax policy and pointed out that when businessmen know what to expect in the way of budget expenditures and tax rates they may be inclined to view the future with somewhat less uncertainty.

In my answer to an earlier question I gave an example of the influence of tax rates on equity and debt financing. I pointed out that the tax structure tends to discourage equity financing and venture capital. It seems apparent that if tax rates did not make the cost of equity capital so high relatively there would be an increase in its supply.

(*d*) Do you feel that it is necessary and proper that Government expenditures be employed to complement business investment expenditures in order to maintain an optimum rate of investment when business investment shows a tendency to decline?

I do not know. I seriously doubt if such a program is necessary but if we are to have a program of Government expenditures to complement declining business investment it should not be undertaken without changes in budget and tax policy. In my answer to question VII (a) I describe what I believe to be the advantages of a stable budget and stable tax rates. I pointed out that under such a system it might be possible to develop surpluses during periods of prosperity that could be used to offset deficits incurred when tax revenues declined. In this framework, the costs of complementing a decline in private investment expenditures by Government investments might be met, in part at least, by revenue surpluses. But Government expenditures should not be begun unless it was certain that depression was resulting from a decline in private investments and not from other factors. Furthermore, there would be little long-run advantage in making heavy expenditures in the form of direct investments in the industrial sector when the economy was clearly not in need of new plant and equipment. The factors contributing to depression vary in importance from cycle to cycle. Under one set of conditions an increase in investment expenditures might accelerate recovery. Under another set increases in direct investment during depression might contribute to excess capacity and enhance the built-in stability of the economy.

When we are sure that an increase in investment expenditures is necessary and that private enterprise is unable to make these expenditures, then it might be proper for the Government to complement declining business expenditures subject to the conditions I have mentioned. It would not be proper for the Government to embark on a heavy expenditures program during prosperity, and incur budgetary deficits at such a time when no sound economic argument can be made for these deficits.

I do not believe that Government should complement business investment expenditures when business investment merely shows a tendency to decline. This is the road to inflation. While it may be possible to dampen severe and violent fluctuations by manipulating investment expenditures it hardly seems possible that moderate fluctuations in our system can be completely eliminated. If the Government were to embark on a heavy expenditures program at the first sign of a tendency to decline then we might as well resign ourselves to chronic deficits in good times and in bad. The minor decrease in business activity of the past summer is a case in point. There we had a moderate fluctuation, a tendency to decline. In the third quarter of 1949 (July–September) the SEC estimated that expenditures on new plant and equipment by United States business would decline approximately $110,000,000 below the April–June quarter. It also estimated for the October–December quarter a decline of $300,000,000 below the July–September quarter. From the best estimates we have been able to obtain business expenditures on new plant and equipment in 1950 will probably continue to decline. Nevertheless, Government spokesmen assure us that 1950 will probably be a prosperous year. Are we to embark on a program of expenditures at current and future high levels of business prosperity to complement private investment expenditures which now appear to be declining? This would be improper and a needless waste of public funds.

Assuming that an optimum rate of investment is a strategic variable, and that the Government must take a hand in complementing declines in private investment, it should do so only when the evidence is clear that we are heading for a depression. This presupposes, of course, that we have a far greater knowledge of the causes of cyclical fluctuations than I believe we have at present, and it also implies that we have defined recession and depression in terms of levels of national income and employment and unemployment. If the argument is made that the proper timing of Government investment expenditures is of importance in heading off depression, even if we are not sure that depression is certain, and that we must run the risk of being too early rather than too late in complementing private investment, then we may as well base our expectations on an economy of inflation, instability, and rapidly mounting deficits. A Government expenditures program of this kind would not only be unnecessary but most improper.

I thank you.

(The supplemental statement and data submitted by Mr. Patrick are as follows:)

SUPPLEMENTAL LIFE-INSURANCE DATA—BANKERS LIFE CO.

A. To what extent do the life-insurance companies evaluate over-all economic trends in determining types of enterprise desirable for investment and the optimum volume of investment by life-insurance companies in such enterprises.

It is my opinion that life-insurance companies have no alternative but to take the savings placed with them from day to day and year to year and invest these savings in the various credit-worthy enterprises that at that time are seeking capital. Naturally, this process requires that not only the individual company but each industry be studied to determine its outlook for future growth, future earnings, and other factors that make investments in it a sound risk in the light of the then existing economic trends. If the phraseology of this question purports to inquire if life-insurance companies plan in any but the broad sense required for diversification, what amount should be invested in different types of industries for the purpose of importantly influencing the direction of economic development, my answer is that they do not.

1. Is there any coordination of life-insurance investment policies among different companies for the purpose of directing the flow of life-insurance investment in relation to over-all economic trend?

I do not know of any coordination of life-insurance investment policies among the different companies for any purpose.

2. Do the life-insurance companies attempt to evaluate the price and profit policies of their corporate industrial borrowers and of industries as a whole in determining investment policies?

Only in the very broad sense that an astute investor recognizes that the price policies of a company and of an industry must be competitive and that the profit policies must yield returns that are reasonable. If these policies produce abnormally high earnings, an investor recognizes that it is hazardous to predicate a long-term investment on the earnings thus derived as the chances are great that competition or social forces will ultimately cause these earnings to be reduced. It is obvious that if these policies produce abnormally low earnings, not much basis exists for making a long-term investment unless such policies can readily be changed and earnings increased.

B. It has been said that life-insurance companies have increasingly drawn funds from localities where they are needed and invested them in localities where they are not needed. What statistical data have you on this question?

In my opinion, the statement that life-insurance companies have increasingly drawn funds from localities where they are needed and invested them in localities where they are not needed is a very deplorable form of regionalism. The unnecessary concern caused by this concept has led to the passage of unfortunate legislation which endeavors to force the investment of funds in the same State in which they are collected. Actually, no tariff or trade barriers exist between the States and thus, the only sound economic viewpoint is that labor, materials, and capital funds should be free to move from place to place as required. Were it not possible for capital funds to move freely between the States, then those areas with surplus savings would be surfeited with capital and those with a deficiency of savings would be in dire need. Because of the reasons given, we see little value in relating the situs of our insurance in force with the situs of the investments held, but we are giving this statistical information as requested.

C. Schedules furnished separately.

D. Schedules furnished separately.

E. Schedules furnished separately.

F. To what extent does the pressure on life-insurance companies to find investment outlets and the consequent demand for fixed interest-bearing obligations contribute to the present low-level of interest rates?

Undoubtedly the demand of insurance companies for fixed value securities when related to the supply of such securities has some effect on interest rates. Of course, it is obvious that insurance company funds are only one type seeking fixed, value securities as individuals, pension and trust funds, savings and commercial banks and many others are also seeking them. However, in recent years, the level of interest rates has been so manifestly the result of United States Government and Federal Reserve Board policies that it would be useless to discuss the minor role affecting interest rates played by funds of savings institutions.

G. It has been observed that corporate debt-asset ratios in the aggregate are fairly conservative under present business conditions, but that these ratios might be changed by the price declines that would result in the event of a severe economic depression. To what extent have the life-insurance companies given consideration to this factor in their industrial loan programs?

We assume that this question is concerned with the effect of price changes on securities of manufacturing and merchandising companies. As mentioned in the testimony with respect to changes in equity/debt ratios in the main body of the testimony, we have attempted to evaluate the effect of price declines upon the credit of companies in which we have investments. Some of the points which are given consideration are:

(*a*) Method of valuation of inventory (LIFO, FIFO, lower of cost or market, etc.)

(*b*) Type, balance, and rate of turn-over of inventory.

(*c*) Is inventory protected by hedging or firm sales contracts?

(*d*) Type of customers and aging of receivables.

(*e*) Ratio of cash and Government bonds/current liabilities.

(*f*) Typical cyclical pattern of sales in industry.

(Effect of price declines on real-estate loans was discussed above in II (*c*).)

(*b*) *Comparison of insurance in force with geographical distribution of assets*

State	Insurance in force Dec. 31, 1948	Book value of assets as of Dec. 31, 1948
Alabama	$1, 926, 450	$1, 619, 640. 36
Alaska	----------	45, 437. 46
Arizona	622, 588	972, 262. 44
Arkansas	----------	422, 555. 04
California	72, 017, 029	28, 389, 997. 05
Colorado	14, 662, 077	9, 922, 239. 33
Connecticut	1, 979, 416	377, 324. 97
Delaware	2, 742, 977	657, 638. 82
District of Columbia	8, 146, 004	937, 696. 67
Florida	----------	959, 716. 33
Georgia	43, 926	1, 449, 832. 29
Hawaii	----------	45, 115. 24
Idaho	20, 424, 293	1, 360, 720. 06
Illinois	137, 792, 522	38, 795, 693. 06
Indiana	48, 365, 094	8, 511, 425. 73
Iowa	208, 963, 087	27, 838, 457. 70
Kansas	29, 971, 045	3, 104, 701. 70
Kentucky	14, 813, 398	1, 488, 421. 45

(*b*) *Comparison of insurance in force with geographical distribution of assets*—Continued

State	Insurance in force Dec. 31, 1948	Book value of assets as of Dec. 31, 1948
Louisiana	$534, 894	$2, 255, 137. 96
Maine	----------	630, 352. 57
Maryland	10, 628, 673	1, 961, 276. 52
Massachusetts	899, 892	1, 721, 298. 39
Michigan	43, 365, 200	5, 769, 465. 50
Minnesota	50, 746, 008	9, 141, 777. 90
Mississippi	----------	575, 930. 29
Missouri	27, 183, 479	4, 916, 238. 11
Montana	21, 113, 371	2, 397, 543. 18
Nebraska	49, 958, 964	7, 415, 515. 07
Nevada	2, 688, 886	117, 378. 89
New Hampshire	3, 000	842, 411. 62
New Jersey	12, 172, 437	2, 066, 025. 43
New Mexico	984, 184	1, 050, 733. 99
New York	89, 758, 397	13, 575, 766. 40
North Carolina	7, 322, 394	1, 118, 739. 16
North Dakota	1, 478, 619	739, 326. 13
Ohio	81, 326, 166	10, 542, 205. 09
Oklahoma	22, 358, 846	2, 315, 895. 09
Oregon	25, 356, 554	1, 737, 252. 19
Pennsylvania	72, 535, 171	7, 043, 523. 69
Puerto Rico	----------	900. 00
Rhode Island	57, 500	593, 253. 11
South Carolina	----------	60, 753. 20
South Dakota	7, 235, 056	780, 644. 47
Tennessee	15, 419, 994	1, 148, 686. 85
Texas	75, 941, 580	55, 293, 412. 76
Utah	9, 430, 220	676, 792. 55
Vermont	4, 644	128, 819. 36
Virginia	13, 105, 726	1, 608, 522. 16
Washington	40, 389, 435	1, 479, 681. 09
West Virginia	15, 546, 383	1, 704, 045. 93
Wisconsin	104, 859, 399	4, 867, 023. 52
Wyoming	2, 767, 107	759, 145. 09
Miscellaneous (not allocable to any single State)	8, 680, 952	15, 179, 729. 52
Canada	----------	8, 363, 653. 93
U. S. Governments	----------	161, 299, 070. 72
Total	1, 376, 323, 037	458, 776, 803. 13

NOTE.—Holdings of companies operating in several States allocated according to split developed by Life Insurance Association of America. Miscellaneous includes assets not feasible to allocate on State or foreign country basis.

Investment portfolio as of Dec. 31, 1948

			Par value
1.	Manufacturing		$20, 863, 388
2.	Trade		5, 550, 479
3.	Electricity, gas, water and telephone		79, 287, 400
4.	Railroads		1, 300, 000
5.	Other transportation		----------
6.	Single family residential real-estate mortgages		74, 066, 605
7.	Multifamily residential real-estate mortgages		12, 304, 052
8.	Multifamily real-estate direct investments		----------
9.	Mortgages on commercial real estate held for rental purposes		3, 564, 004
10.	Mining, including oil and gas		2, 784, 000
11.	U. S. Government securities		161, 092, 600
12.	Securities issued by public authorities other than U. S. Government:		
	(*a*) Drainage and reclamation	$572, 000	
	(*b*) Electric light and power	956, 000	
	(*c*) Funding and/or refunding	568, 000	
	(*d*) Housing	1, 000, 000	
	(*e*) Roads and streets	6, 100, 740	
	(*f*) School	172, 000	
	(*g*) Sewer	468, 723	
	(*h*) Water	770, 000	
	(*i*) General	536, 532	
			11, 143, 995

(*d*) *Analysis of industrial investments*

1. GEOGRAPHICAL LOCATION OF INVESTMENTS (BOOK VALUE)

	Acquired in 1948	Owned as of Dec. 31, 1948
Alabama	$800,140	$1,595,583
Arizona	901,843	901,843
Arkansas	192,065	360,136
California	3,599,366	10,714,960
Colorado	529,368	1,454,173
Connecticut	31,003	353,226
Delaware	454	613,327
District of Columbia	337,616	852,743
Florida	152,621	846,187
Georgia	326,066	1,445,532
Idaho	1,028,259	1,035,924
Illinois	2,927,038	9,446,796
Indiana	1,112,507	3,798,293
Iowa	1,781,560	7,176,045
Kansas	825,602	2,419,378
Kentucky	352,135	1,179,907
Louisiana	879,509	1,990,032
Maine	15,768	630,353
Maryland	519,149	1,844,968
Massachusetts	542,524	1,716,617
Michigan	2,231,609	4,772,008
Minnesota	1,405,273	2,673,007
Mississippi	239,509	575,930
Missouri	406,291	2,753,222
Montana	388,612	400,011
Nebraska	559,489	1,558,287
Nevada	65,970	90,747
New Hampshire	512,923	842,412
New Jersey	614,121	1,780,202
New Mexico	240,429	252,660
New York	2,398,019	7,957,101
North Carolina	644,305	985,647
North Dakota	547,846	739,326
Ohio	1,971,005	6,385,686
Oklahoma	562,079	2,009,886
Oregon	441,296	1,313,151
Pennsylvania	1,504,111	5,937,903
Rhode Island	521,283	593,246
South Carolina		60,753
South Dakota	163,872	259,205
Tennessee	343,457	693,346
Texas	1,179,903	3,882.722
Utah	528,946	541,687
Vermont	121,154	128,819
Virginia	387,223	1,502,581
Washington	116,371	627,325
West Virginia	394,755	1,446,551
Wisconsin	859,791	3,140,447
Wyoming	50,267	60,314
Miscellaneous	3,302,657	6,401,845
Total	39,557,159	110,742,050

NOTE.—Holdings of companies operating in several States allocated according to split developed by Life Insurance Association of America. Miscellaneous includes assets not feasible to allocate on State or foreign country basis..

2. SIZE OF INVESTMENTS (PAR VALUE)

	Acquired in 1948	Number	Owned as of Dec. 31, 1948	Number
Under $25,000	$82,500	7	$241,493	22
$25,000 to $50,000	143,000	4	434,128	12
$50,000 to $100,000	465,000	9	1,921,138	28
$100,000 to $300,000	11,000,300	58	28,235.710	139
$300,000 to $500,000	8,374,000	23	21,668,600	59
$500,000 to $1,000,000	13,236,000	25	42,104,198	73
$1,000,000 and over	6,250,000	6	15,180,000	13
Totals	39,550,800	132	109,785,267	346

(*d*) *Analysis of industrial investments*—Continued

3. PRODUCT OR SERVICE (PAR VALUE)

	Acquired in 1948	Owned as of Dec. 31, 1948
Auto parts	$50,000	$390,360
Automobiles	190,000	386,303
Baking and milling	----------	1,009,250
Beverages	50,000	62,314
Builders	27,500	73,789
Chemicals	220,000	560,000
Coal	493,000	768,000
Confectionery	----------	2,208
Containers (metal, glass)	104,000	153,759
Drugs and cosmetics	298,000	944,250
Electrical products	900,000	1,444,909
Finance and small loan companies	1,432,000	2,112,786
Food products	78,000	1,329,823
Household furnishings	780,000	810,566
Leather and shoes	153,900	371,900
Machinery, agricultural	----------	420,000
Machinery, industrial	250,000	630,739
Meats and dairy products	1,256,000	4,933,000
Metal fabricators	----------	49,246
Metals, nonferrous	----------	650,000
Miscellaneous	190,000	1,778,144
Oil	----------	2,016,000
Paper	750,000	1,180,000
Printing	65,000	63,701
Railroads	1,550,000	1,300,000
Retail trade chains	1,525,000	1,597,500
Retail trade department stores and mail order	376,000	923,320
Soaps and vegetable oils	20,000	20,000
Steel and iron	200,000	975,000
Textiles and apparel	----------	350,000
Tires and rubber	550,000	1,511,000
Tobacco	760,000	960,000
Utilities, gas and electric	21,197,400	66,948,400
Utilities, telephone and telegraph	5,365,000	12,339,000
Wholesale	720,000	720,000
Totals	39,550,800	109,785,267

4. PURPOSE OF LOAN

Purchase of plant and equipment	$26,299,900	$42,124,179
Working capital	6,837,000	13,330,329
Refunding	6,413,900	54,330,759
Total	39.550,800	109,785,267

5. INTEREST RATES

2.25 to 2.49	$130,000	$130,000
2.50 to 2.74	995,000	7,160,000
2.75 to 2.99	1,800,000	27,075,250
3.00 to 3.24	17,969,000	34,931,000
3.25 to 3.49	6,610,000	17,029,000
3.50 to 3.74	1,883,900	9,787,586
3.75 to 3.99	2,125,000	3,729,110
4.00 to 4.24	3,575,400	4,666,503
4.25 to 4.49	300,000	337,739
4.50 to 4.74	2,312,500	2,761,192
4.75 to 4.99	470,000	770,000
5.00 to 5.24	1,374,000	1,401,279
5.25 to 5.49	----------	----------
5.50	6,000	6,608
Total	39,550,800	109,785,267

7. FORM OF INVESTMENT CONTRACT

Purchase and lease-back	$250,000	$680,839
Mortgage bonds	20,915,500	69,034,628
Debentures	13,564,000	30,771,000
Convertible bonds	----------	----------
Preferred stock	4,821,300	9,298,800
Common stock	----------	----------
Total	39,550,800	109,785,267

(*e*) *Manner of placement of industrial investments*

[Total corporate securities acquired through underwriters in 1948, $30,898,300 (par value)]

INVESTMENTS IN RESIDENTIAL PROPERTIES BY SIZE OF LOAN

	Acquired in 1948	Number	Owned as of Dec. 31, 1948	Number
Individual homes:				
Under $5,000	$2, 213, 940. 25	845	$18, 177, 634. 84	5, 663
$5,000 to $14,999	22, 849, 733. 40	3, 127	54, 033, 365. 64	7, 611
$15,000 to $34,999	1, 140, 487. 92	63	1, 855, 604. 10	102
$35,000 to $99,999				
Total	26, 204, 161. 57	4, 035	74, 066, 604. 58	13, 376
Multiple-family dwellings:				
Under $5,000	49, 169. 10	15	451, 710. 68	144
$5,000 to $14,999	659, 240. 49	72	3, 164, 505. 23	393
$15,000 to $34,999	527, 497. 41	26	1, 544, 267. 81	76
$35,000 to $99,999	915, 679. 84	13	2, 250, 476. 92	37
$100,000 to $499,999	1, 889, 001. 31	11	3, 459, 977. 52	19
$500,000 and over			1, 433, 114. 06	2
Total	4, 040, 588. 15	137	12, 304, 052. 22	671

The CHAIRMAN. We are certainly very much indebted to you, Mr. Patrick; I think it has been a most stimulating discussion. And I want to thank you on behalf of the committee for the great care with which you have prepared this paper.

That same expression of gratitude goes to all who have cooperated. The insurance industry worked most closely with Mr. Scoll and the staff in gathering this material. Much of it still remains to be analyzed, but I have not a doubt in the world that the result will be beneficial for all concerned.

We are to get some additional information from Mr. Woodward, and then next week we shall start with another phase. This has been merely the life-insurance consideration.

Mr. PATRICK. May I say, sir, you are very generous in your remarks. Although I have no mandate to speak for the insurance industry, we do appreciate greatly the courtesy you have shown us.

The CHAIRMAN. Well, we could not do less, certainly.

When the committee reassembles on Monday morning at 10 o'clock, the first witness will be Dr. Allen B. Du Mont of the Du Mont Laboratories. As the name indicates, he will discuss the financing of a new enterprise.

In the afternoon, representatives of the American Research and Development Corp. will appear, Mr. Horace Ford and Mr. Merrill Griswold, and their testimony, I think, will outline the efforts that have been made by that group to provide new opportunities for investment and how they have handled the problem.

The committee will now stand in recess until 10 o'clock on Monday morning.

(Whereupon, at 12:15 p.m., the committee recessed, to reconvene at 10 a. m., Monday, December 12, 1949.)

VOLUME AND STABILITY OF PRIVATE INVESTMENT

MONDAY, DECEMBER 12, 1949

Congress of the United States,
Joint Committee on the Economic Report,
Subcommittee on Investment,
Washington, D. C.

The subcommittee met, pursuant to adjournment, at 10:30 a. m., in the caucus room, Senate Office Building, Senator Joseph C. O'Mahoney (chairman) presiding.

Present: Senator O'Mahoney and Representative Herter.

Also present: David Scoll, special counsel to the committee, and Theodore J. Kreps, director of staff.

The Chairman. The committee will come to order.

Mr. Scoll, I understand your first witness this morning will be Dr. Du Mont of the Du Mont Laboratories. Will you state for the record what the purpose of this testimony will be.

Mr. Scoll. Yes, sir. We have asked Dr. Du Mont of Du Mont Laboratories, designers and manufacturers of television equipment, to appear before the committee today to tell us the story of Du Mont, which is a case history of a successful American business that started out in 1931 with an investment of $500 and by 1949 had achieved gross sales of $45,000,000.

The Chairman. Started in what year?

Mr. Scoll. 1931.

The Chairman. With $500?

Mr. Scoll. With $500 and achieved a gross sales volume of approximately $45,000,000 in 1949.

We thought that Dr. Du Mont could give us a statement and discussion of the problems of starting a business and achieving success under the existing vicissitudes of business in America and thereby furnish the committee with a specific case history on how it is done in spite of the handicaps.

The Chairman. We might, perhaps, add, Mr. Scoll, how in spite of handicaps this organization or this gentleman who started it took advantage of American opportunity, too.

Dr. Du Mont, we will be very glad to have you proceed.

STATEMENT OF ALLEN B. DU MONT, ALLEN B. DU MONT LABORATORIES, INC., PASSAIC, N. J.

Dr. Du Mont. Thank you. I have no prepared statement with me, but I have several exhibits which I would like to introduce as I go along, which will clarify the figures a little bit.

The Allen B. Du Mont Laboratories was founded in 1931. The original capitalization of the company was $500, which I contributed, and $500 which a friend of mine put into the company. This capital only provided for operation for a couple of months. At the end of that time additional finances were supplied by myself for 4 years.

I think it might be appropriate at this time to have exhibit 1 and exhibit 2 before the members of the committee.

The CHAIRMAN. Exhibit 1 is the statement of sales, employees, profit or loss after taxes, with the fourth column cumulative; is that right?

Dr. DU MONT. Cumulative profit and loss; yes, sir.

The CHAIRMAN. This may be inserted in the record at this point.

Dr. DU MONT. And exhibit 2, also. Could that be put in?

The CHAIRMAN. Yes; it may also be received. This is the one which refers to the amount of stock issued from year to year, common stock and convertible preferred; then there is a column on patent rights, one on mortgages, and one on loans.

These will both be inserted.

Dr. DU MONT. In exhibit 2 it shows in 1931 under "Loans" $500. This was the original loan I received at the start of the business. For the first 4 years of the business you will notice opposite 1934 "$25,000." In other words, that was my investment during those 4 years in the business.

I also contributed my services. In other words, I did not take any sums from the company during that time for salary.

The CHAIRMAN. An interesting feature of this exhibit would seem to be, Doctor, that while you started with a loan of $500 in 1931, you did not get any patent rights until 6 years later in 1937.

Dr. DU MONT. That is correct.

The CHAIRMAN. But you certainly were working with some sort of invention all this time, were you not?

Dr. DU MONT. I will go back. I just want to give you a brief history of the start of the company and then I will go back and try to explain the position of the art at that time.

During those first 4 years in order to be able to get along, I did consulting work on the outside 2 or 3 days a week, which gave me sufficient funds to replace the salary which I could not take from the business.

In 1935 the business was incorporated and you will notice $16,000 shown there in mortgages. At that time I took a chattel mortgage on the equipment that the company had and also received some stock in the company for my services and patents which I had developed up to that time.

I would like to have you just take a look at exhibit 1, which shows the sales during this same period. In 1931 the sales, as you mentioned before, were $70; in 1932, $1,850; in 1933, $12,261; and in 1934, $18,179; 1935, $36,413.

In spite of the fact that these sales are obviously rather insignificant today, we were able by careful management to about break even during that period.

The CHAIRMAN. What were you selling?

Dr. DU MONT. I will go back now and try and indicate just what this laboratory consisted of and also what it was trying to accomplish.

The laboratory was formed in 1931 with the idea of developing cathode-ray tubes for television. I have here on the desk the largest cathode-ray tube made at the present time for use in television receiving sets. I also have one of the smallest tubes made. This happens to be a tube which is used in various radar apparatuses for checking the wave form and pulses, and so forth.

The situation as of 1931, if we take a broad look at the field, was this: We were interested in developing cathode-ray tubes for television. Prior to that time there had been a few cathode-ray tubes made on an experimental basis in this country.

These particular cathode-ray tubes were of the so-called gas-focus type. They were very difficult to build, very expensive, and only lasted a short period of time. Our purpose in starting this laboratory, in starting development, was to try and develop a tube that could be made economically in quantity and which would last a long time.

The work we did was in developing a cathode-ray tube to operate in a high vacuum rather than being gas filled. The development work from 1931 to date has been the development of this cathode-ray tube.

In developing the company along the lines of the cathode-ray tube, it has been our policy in addition to manufacturing the tube to manufacture the various apparatuses in which the tube is used.

The CHAIRMAN. Would you, for the sake of the record, so that those who may read will clearly understand, tell us what you mean by a cathode-ray tube?

Dr. DU MONT. A cathode-ray tube is a vacuum tube which has an electronic gun at one end and at the other end it has a large face plate coated with fluorescent material. The electron beam can be deflected—in other words, it can be moved up and down and from side to side by means of deflection coils, and the intensity of the spot can be changed by means of a grid.

So you can use this tube to form a picture or to show wave forms or anything like that, any electrical or any mechanical phenomena. That is the cathode-ray tube.

Mr. SCOLL. What is the theory of the tube? Is it to transform electrical pulses into light?

Dr. DU MONT. It is to transfer or transform electrical impulses into either pictures or wave form. The big advantage of the tube is that the paint brush, which forms the picture, has practically no weight. It is just a stream of electrons.

In other words, if you try to do this mechanically, you just could not move the paint brush fast enough to form the picture. Here you just have a beam of electrons that forms the picture.

That is the big advantage. Of course, it takes practically no power to move this, because it has no weight.

But that is the fundamental basis of the business, this cathode-ray tube.

Mr. SCOLL. One further question. The cathode-ray tube is also the principal element in all of television, is it not?

Dr. DU MONT. The cathode-ray tube is the reproducing element in television, and I will explain a little later that until we got a satisfactory cathode-ray tube television was not practical. The face of the tube is where the picture appears.

Mr. HERTER. May I ask a question? During the first 5 years you were experimenting on this and working it out, what other concerns in the United States were doing research work parallel to yours, so to speak, along the same lines?

Dr. Du Mont. The only concern I know of offhand that was doing work at that time was the Radio Corp. of America. However, we were able to develop the tubes so that they were sufficiently good to sell in 1932. They did not put them on the market until 1936.

Mr. Herter. They had research equipment entirely different from yours?

Dr. Du Mont. They were doing research work, but not selling the tubes commercially.

I might just explain that when we started in 1931 and then around 1932 started selling tubes in small quantities we very soon found out that television was a long way off and that we were going to starve to death if we tried to sell these tubes just for television applications.

So we started in 1932 and manufactured cathode-ray oscillographs.

The cathode-ray oscillograph is a device used in the industry for studying wave forms. It is used in medical applications for studying heart action, nerve action. It is used in the mechanical industries for studying vibrations. From 1931 until 1939 the sales, as indicated here, of the company were of cathode-ray tubes and cathode-ray oscillographs.

In the annual report of 1948—I think you have a copy of it—perhaps I had better refer you to this Employees' Digest, so I can get the exact page number for you.

In the Employees' Digest book, of which you have a copy—that is this green book—page 31, there are photographs of various cathode-ray oscillographs which we manufacture at the present time. There is a short description there of the uses of this instrument.

So the operation of the company from 1931 to 1939 was simply in the manufacturing of cathode-ray tubes and selling them and manufacturing cathode-ray oscillographs and selling them.

During that period of time, however, we did a lot of experimental work with television, and around 1938 the art had advanced sufficiently so that we started manufacturing television receivers in small quantities.

In 1941 our present standards for transmitting television were set, in July of that year. So at about that time we started really setting up for production, but the war coming in December of that year cut short the development of television.

During the war years—namely, from about 1941 to 1945—we manufactured these cathode-ray tubes for use in radar equipment. They are used as the indicator in the radar apparatus to show the chart or diagram desired in the same way that they are used to form the picture in the television receiver.

We also manufactured during that period of time radar equipments and loran equipments used by the Army and Navy.

At the end of the war we had a problem of conversion back to peacetime, and we started manufacture of television receivers in large quantities and also the manufacture of television transmitters. Now, the actual experimental work on transmitters had started back in 1937–38, so we had been working on transmitters for almost 10 years before we sold any commercially.

Likewise, in the operation of television stations. This company operates three television stations: One in New York, one in Washington, and one in Pittsburgh.

We started experimenting in the operation of stations back in 1939, but the full pressure for expansion did not come until after the war.

If you will refer to exhibit 1, I would just like to comment very briefly on the sales figures there. You will note that from 1931 through 1940 we had a steady increase with the exception of one year, 1938, and then from 1941 to 1945 the sales went up very, very materially. That is due to the war production.

In 1946 sales dropped very materially, and that was due to the conversion from war production to peace production. As you will notice, from 1946 to 1949 there has been expansion of the business from sales in 1946 of $2,287,000 to $45,000,000 in 1949. As a matter of fact, at the present time we are running at a rate of $70,000,000, and we estimate that 1950 should be somewhere around $80,000,000 in sales.

Looking at the profit and loss column, the cumulative column, the one farthest to the right, you will notice that since the start of the business we really did not get into the black until 1948 permanently. We were in the black for 3 or 4 years during the war, but then the large cost of conversion to peacetime put us in the red. So that as of the present time we have made over this term of years from 1931 until now some $5,356,000, the profit really being in the last 2 years.

Going back to exhibit 2, I just briefly covered the period of time to 1934. You will notice that the first money that we received in the company, outside of the original money that I had put in, was in 1937 when we sold some patent rights for $15,000. Then in 1938 we tried equity financing and we had a Wall Street house that attempted to put an issue of common stock out for us that was supposed to be $200,000. They only sold around $11,000 worth of the common, and there were expenses of $3,000 in connection with the lawyers and the SEC, so as you notice there, on our first equity financing we netted $8,082.

Mr. SCOLL. Was that the first effort you had made to sell stock in your enterprise?

Dr. DU MONT. As far as I know, yes.

The CHAIRMAN. You would know.

Dr. DU MONT. Yes; that is really the first. When we originally formed the company, there was stock issued, of course, but the only money that was put up was just by one single person. We did not attempt to go to the public with it. This is the first attempt to interest the public in any investment.

Mr. SCOLL. Before that time, according to exhibit 2, you show that your financing consisted exclusively of the sale of patent rights, mortgages on property. I presume that is mortgages on the corporate property.

Dr. DU MONT. The $16,000 was a chattel mortgage I had on the equipment and the difference between 16,000 and 35,625 was a mortgage we had on the building we purchased.

Mr. SCOLL. And loans which were made by officers, I take it, and the loans that were $25,000——

Dr. DU MONT. That was the money I had put into the company.

Mr. Scoll. So that up until 1938 the company had been financed entirely by loans and mortgages on property except for the $15,000 sale of patent rights and except what you netted on the sales of your products; is that right?

Dr. Du Mont. That is right.

Mr. Scoll. So for the first 7 years you did not go outside for capital.

Dr. Du Mont. That is right.

The Chairman. When you were incorporated, how much capital stock was authorized?

Dr. Du Mont. There were 50,000 shares of stock authorized, and I received 25,000 shares for my services over the first 4 years, plus patents which I owned and had developed.

The Chairman. Was this a par value or no par value stock?

Dr. Du Mont. I do not remember what it was at that time. It is 10 cents par value right at the moment. The stock is 10 cents par value.

The Chairman. But at the time you were organized——

Dr. Du Mont. I think it was no par. I am not sure.

The Chairman. The stock was issued to the organizer?

Dr. Du Mont. It was issued half to the organizers, there were certain expenses in connection with organizing the company, and what not, and the people that helped me were to receive 25,000 shares, and I received 25,000. There was very little money put in at that time, except what it cost to incorporate the company.

The Chairman. The issuance of stock did not produce any capital for the company?

Dr. Du Mont. That is right.

The Chairman. It produced the patent rights, it produced compensation to you for the services that you had contributed, and it was, in other words, what has commonly been called promotion stock.

Dr. Du Mont. That is right.

The Chairman. Then the first time that any money was obtained from the sale of stock was in 1938, when you received a net of $8,082 through the stockbrokers?

Dr. Du Mont. Common stock; yes. Then in that same year, because the amount we had received on that was rather inadequate, we agreed to sell some common stock, $56,000 worth of common stock, to Paramount Pictures Corp. I believe it was 56,000 shares of stock at $1 a share. In the meantime, we changed the capitalization of the company so that instead of having 50,000 shares of the old stock, we had 56,000. So you had a company where you had 56,000 shares of A stock, which were owned by the people previously in the business, and 56,000 shares of B stock owned by Paramount.

It was set up at that time so that the A stock elected the president and vice president, and the B stock elected the secretary and treasurer; so that the actual operating control of the company was in the hands of the A stockholders.

At the start we had four A directors and four B directors, so that you had a negative control by the B. Later on, however, as we increased the A shares and kept the B shares the same, we had five A directors and three B directors, so that the people owning the A stock had complete control of the company; and that is the situation that exists today. The A stockholders have five on the board of directors and the B stockholders have three.

The CHAIRMAN. Who are the A stockholders?

Dr. DU MONT. The A stockholders are pretty generally the public. I have the largest amount of A stock, but it is a relatively small percentage. There is a total at the present time, just in rough figures, about 2 million shares—1½ million of A and a half million of B.

The CHAIRMAN. What would you say is the average individual holding?

Dr. DU MONT. Well, there are 13,000 stockholders in the company, and as I remember the figures, there are only about 10 stockholders that have over 5,000 shares. I think the average holding is between 50 and a hundred shares—very widely distributed.

The CHAIRMAN. So that actually the control still resides in yourself and those who have more than 5,000; is that right?

Dr. DU MONT. For practical purposes that is true.

The CHAIRMAN. For all practical purposes.

Dr. DU MONT. That is correct. Well, if we go on here, in 1939 we put out a convertible note issue of $610,000, and we later were fortunate in having it converted into common stock, so that in effect this $610,000 was equity financing.

Mr. HERTER. How did you dispose of that?

Dr. DU MONT. Well, we called the stock. You see, we could call it.

Mr. HERTER. How did you finance that note issue? Was it done through a bank?

Dr. DU MONT. It was done through a Wall Street investment house. Then in 1944 we had a common-stock issue, and this netted the company $1,414,375. In 1946 we had another common-stock issue, which netted the company $4,006,375.

Mr. SCOLL. May I go back a second? Did you have much trouble selling that stock issue in 1944?

Dr. DU MONT. I would not say we had any particular difficulty. There was at that time, as there is now, a very great interest in television and I think that helped materially in being able to sell it.

Mr. SCOLL. That was done through a normal underwriting procedure?

Dr. DU MONT. That is correct, normal underwriting.

Mr. SCOLL. The same for 1946?

Dr. DU MONT. The same for 1946. Now, in 1948, I am going down the column marked "Common," we show $107,000 received from the sale of stock. The bulk of that was stock which we sold to the employees. At the time we had the underwriting in 1946 we got permission from the stockholders and the SEC to have some stock available for employees, and that $107,000 is primarily that.

The amount shown in 1949 of $626,000 was some warrants that we gave the underwriters in 1946; so that the amount received in 1948 and the amount received in 1949 were really not separate and new financing. They were hang-overs from the 1946 financing.

However, in 1948 we did put out an issue through underwriters of convertible preferred stock to the amount of $2,645,000. In other words, in 1948 the market for equity capital was such that we thought we could do better with convertible preferred stock than we could with common stock, and it was put out at that time.

I have just a few other comments on this exhibit No. 2.

Mr. HERTER. How many shares of common stock do you have outstanding now?

Dr. DU MONT. At the present time there are approximately a million and a half of A, and a half million of B.

Mr. HERTER. About 2,000,000 shares?

Dr. DU MONT. That is right.

Mr. HERTER. Do they share equally?

Dr. DU MONT. They share equally in every respect. It is simply that the A stockholders can elect five directors, the B stockholders can elect three, and A stockholders elect the president and the vice president, and the B stockholders elect the secretary and treasurer.

Mr. HERTER. They share alike in the proceeds of the company?

Dr. DU MONT. That is right.

Mr. HERTER. You say you have roughly a million and a half outstanding shares?

Dr. DU MONT. One and one-half million of A and a half-million of B.

Mr. HERTER. The 10-cent par value was just an arbitrary par value?

Dr. DU MONT. I think I may have missed out in here. Somewhere around 1941 or 1942 the stock was split up 10 for 1, which accounts for the increase in amount. We still actually have some unissued stock in the treasury, too.

You see, we started over here with 56,000 A and 56,000 B, and then it was 10 to 1, so that would make it 560,000, and then later on we authorized additional A. It was always an increase of A stock whenever we financed, rather than B.

You will notice in this exhibit that we have over the years received fairly substantial amounts for patents, and the amounts we received from the various things we have developed have been very helpful in financing the company.

Mr. HERTER. Were those outright sales?

Dr. DU MONT. I do not believe there were any outright sales. They are all some form of license arrangement. In other words, we have retained rights under all the patents, so that we have the use of them fully now.

Mr. SCOLL. What has been your licensing policy on patents? Have you licensed some of your competitors to use your patents?

Dr. DU MONT. Generally speaking, our license policy is to grant anybody a license who desires to use the patent. We do not hold back licenses from anybody.

Mr. SCOLL. I take it that you pursued that policy from the beginning; is that right?

Dr. DU MONT. Yes; we have, but I think you must realize the really great interest in this business has only been for the last 2 or 3 years. In other words, as you can see by our sales record here, in 1946 it was a $2,000,000 business and it has grown to where right at the present time we are operating at a rate of $70,000,000. So that the interest before that time was very, very minor, as far as patent rights were concerned.

(Exhibits Nos. 1 and 2 submitted by Dr. Du Mont, are as follows:)

ALLEN B. DU MONT LABORATORIES, INC., PASSAIC, N. J.

Exhibit 1

Year	Sales	Employees	Profit or loss	Cumulate
1931	$70.00	3½		
1932	1,850.73			
1933	12,261.13			
1934	18,179.78			
1935	36,413.75	12		
1936	71,035.00			
1937	103,679.00		$2,561	$2,561
1938	94,200.00	40	(8,581)	(6,020)
1939	117,011.00	61	(95,105)	(101,125)
1940	176,192.00	116	(78,599)	(179,724)
1941	648,028.00	214	(22,979)	(202,703)
1942	2,172,824.19	530	130,164	(72,539)
1943	4,648,345.71	927	206,824	134,285
1944	9,129,507.39	1,215	245,974	380,259
1945	6,971,497.53	998	37,650	417,909
1946	2,287,167.00	1,239	(1,472,270)	(1,054,361)
1947	11,112,363.00	1,673	563,677	(490,714)
1948	26,934,239.00	2,529	2,701,767	2,211,083
1949	[1] 45,000,000.00	3,084	[1] 3,000,000+	5,211,083

[1] Estimated.

Exhibit 2

Year	Common	Convertible preferred	Patent rights	Mortgages	Loans [1]	Sale of assets
1931					$500	
1932						
1933						
1934					25,000	
1935				$16,000		
1936				16,000		
1937			$15,000	35,625		
1938	$8,082 56,000			34,125		
1939	[2] 610,000					
1940					30,000	
1941			92,500		40,000	
1942				13,300	84,000	
1943			150,000	25,840	152,000	$112,850
1944	1,414,375		175,000	21,800	1,050,000	
1945			150,000	15,130	450,000	
1946	4,006,375		150,000	245,423		
1947				230,898	1,500,000	
1948	107,000	$2,645;000	178,007	1,591,928	[3] (2,500,000)	
1949	626,000		250,683	1,470,000	[3] (3,500,000)	
Total	6,827,832	2,645,000	1,161,190	1,470,000		112,850

[1] As of end of year.
[2] Issued as convertible notes.
[3] ( ) Bank credit available by agreement.

Mr. SCOLL. Are you now licensing competitors?

Dr. DU MONT. Oh, yes.

The CHAIRMAN. With respect to exhibit No. 2, the figures at the bottom represent dollars, do they not?

Dr. DU MONT. That is correct.

The CHAIRMAN. So that this would show that you have received throughout this entire period $6,827,832 from the sale of common stock?

Dr. DU MONT. That is correct.

The CHAIRMAN. And $2,645,000 from the sale of preferred?

Dr. DU MONT. That is right.

The CHAIRMAN. That your patent rights brought you $1,161,190; and from mortgages——

Dr. DU MONT. The mortgage figure there is simply the amount of mortgage as of the end of the year. At the present time we have mortgages of $1,470,000.

The CHAIRMAN. Yes; I see that, of course, is not the sum total.

Dr. DU MONT. That is right.

The CHAIRMAN. Were those mortgages issued for the purpose of raising capital?

Dr. DU MONT. No; all these mortgages are on buildings that we own—straight mortgages on buildings.

The CHAIRMAN. Were they given for the purpose of raising capital or in the purchase of equipment?

Dr. DU MONT. In the purchase of buildings, not equipment—just buildings.

The CHAIRMAN. In other words, this was merely the manner in which you financed the acquisition of property?

Dr. DU MONT. That is correct.

The CHAIRMAN. So that this does not go into your capital stock at all?

Dr. DU MONT. No, that is right. In other words, we have resorted to all methods of obtaining funds in order to arrive at our present position.

Mr. HERTER. This does not show anything with regard to plowing in profits?

Dr. DU MONT. No. Only on exhibit 1, we have available $5,356,000, which likewise helped us finance the business. I mean you did have that amount to plow back.

The CHAIRMAN. Do you have a statement of your assets now?

Dr. DU MONT. I have the 1948 annual report, which is the latest we have published. And the situation since that time has improved. But I think this gives you a very good indication of just where the company stands.

The CHAIRMAN. In order to make this exhibit 2 complete, do you not think it would be well for you to give your own estimate of what the asset value of the company is now, since this statement shows that you started in 1931 with a loan of $500?

Dr. DU MONT. Well, I just have some tentative figures.

As of November 6 the assets of the company: Cash, $6,494,000; accounts receivable, $3,567,000; inventories, $5,463,000; and prepaid expenses of $191,000; making a total of currents assets of $15,717,000.

Then the fixed assets consisted of land, buildings and improvements of $3,890,000; machinery, tools and equipment, furniture and fixtures, $2,761,000; broadcasting transmitters, $1,210,000; making a total of $7,862,000; less reserve for depreciation of $1,415,000, or a net of $6,411,000; other assets of $246,000; making a total of assets of $22,376,000.

I presume you would like the liabilities against that?

The CHAIRMAN. You have answered the question I had in mind, but I will be very glad to have you put the liabilities in. Somebody else might want to ask that question.

Dr. DU MONT. All right, it will only take a second.

The accounts payable, $4,747,000; and accrued liabilities of $2,772,000; making a total current liabilities of $7,522,000.

We have the mortgages payable, which is shown on the other sheet here, of $1,470,000. We have deferred income of $23,000; a reserve for contingency of $50,000. Then you have capital stock, surplus paid in, of $6,689,000. And then you have your earned surplus of $3,824,000. And the combination of your two surpluses adds up to $10,165,000. Of course you balance out $22,000,000 liabilities against $22,000,000 assets, but you have $10,000,000 paid-up and earned surplus in the business at the present time.

The CHAIRMAN. Would it actually be the fact to say that the record of your company indicates that the principal source of your capital has been the proceeds from the sale of the commodity which you have manufactured in this business?

Dr. DU MONT. Actually the sale of common stock is slightly higher than the proceeds from the business.

The CHAIRMAN. Yes, but, of course, you operated at a great loss here for several years?

Dr. DU MONT. That is right.

The CHAIRMAN. And the sales kept mounting so that they took up all of the losses that you incurred during this entire period.

Dr. DU MONT. That is right.

The CHAIRMAN. So this $5,356,161, which is your cumulative profit in 1949, has been attained only after you have recouped all of the previous losses?

Dr. DU MONT. Yes, that is correct.

The CHAIRMAN. So that the sale of the commodity has been the principal source of your revenue?

Dr. DU MONT. Yes, I think that is correct, if you look at it from that angle.

The CHAIRMAN. You have been fortunate in that you pioneered in a field in which there was tremendous public interest but which could capitalize only by scientific knowledge such as you and your associates possess.

Dr. DU MONT. That is correct. There is a great public interest in this particular field. I think most people feel it is a rather new development. Here we have shown approximately 20 years where we have been bringing it up to the present point. And the actual first invention on it was in 1880. It was before radio, even.

Laughton and Perry in England took out the first patent in 1880, and the scanning principle which we use today was patented in 1883, by Nipkow. So that actually while people think television is a new art, it is 69 years old this year.

The CHAIRMAN. What do you mean by the scanning principle?

Dr. DU MONT. In transmitting the picture, a beam of electrons scans the picture tube from left to right and top to bottom, and the picture is re-formed on this cathode-ray tube by a spot which moves from left to right and top to bottom. You see a whole picture, but actually there is only one little spot that is illuminated at one time.

And the principle of breaking a picture up so you can send it over one television channel, or one coaxial cable, is the principle of scanning.

Laughton and Perry, in 1880, which was before the principle of scanning, the way he transmitted the pictures, he had several thousand individual photoelectric cells and a wire from each cell going to little lights at the receiver. If he wanted to get a picture with as good detail as we have today, he would need a quarter of a million photoelectric cells, a quarter of a million wires, and 250,000 little lights at the other end. Obviously that is rather impracticable, but the basis of breaking it up so it would be sent over a single wire was invented in 1883 by Nipkow.

The CHAIRMAN. Television is practical, if I understand your description, now only because you have developed the method whereby the stream of electrons which flows at a tremendous speed can be moved across the picture that you desire to send, from left to right and from top to bottom with such rapidity that to the human eye the transmission of this innumerable amount of pictures of spots comes out as a single picture?

Dr. DU MONT. That is correct. In other words, your eye has a certain amount of rententivity. That is the same as in motion pictures. In other words, actually your motion pictures are just a series of still pictures.

The CHAIRMAN. It is a much better use of electrons than has been devised for the atom bomb, I would think.

Dr. DU MONT. It certainly is a more practical application, anyway.

The CHAIRMAN. With respect to practicality, that is another question.

Dr. DU MONT. It is more useful.

The CHAIRMAN. That is right; it is not destructive.

Dr. DU MONT. That is right.

Mr. HERTER. I would like to ask one thing in connection with the balance sheet you have just been talking about.

Dr. DU MONT. Yes.

Mr. HERTER. You carry your patent and patent applications and licenses at a figure of $171,515.

Dr. DU MONT. That is right.

Mr. HERTER. How do you arrive at that figure? Is it purely an arbitrary figure?

Dr. DU MONT. The only we set up on patents, to be conservative, is the actual fees.

Mr. HERTER. The actual cost of securing your patents?

Dr. DU MONT. The actual amounts you pay the Patent Office, and the amount we pay the lawyers for the filing of the application.

The expenses for the research department are charged into current operations. It is such a large part of our business. Over 10 percent of our employees are employed in the engineering department, and we have always done that, and it is a straight current charge. There is no capitalization of any of the engineering done on the patents.

Mr. HERTER. I was wondering in connection with that because in your agreement with your preferred stockholders, rather in your loan agreement, I notice you have to maintain a certain ratio of assets to liabilities.

Dr. DU MONT. Yes.

Mr. HERTER. And you certainly carry your patents at a very low figure, do you not?

Dr. DU MONT. That is right.

Mr. HERTER. In your assets column.

Dr. DU MONT. That is right.

Just one other section on exhibit 2 here. We show over the years the amount that we have borrowed. And in 1948 and 1949, I just wanted to call to your attention that we are not borrowing at the present time, but that these figures that you see are commitments we have from various banks where we can borrow up to that amount if we need it. And right at the moment we have no bank borrowings.

Now I do not know whether this covers the subject completely enough of the development of this company or not.

I might say that as far as the television picture is concerned from 1883 up until about 1931, the bulk of the development work had been done with scanning disks. In other words, they had attempted to re-form the picture at the receiver by means of a scanning disk with a lot of holes in it and reproduce the picture that way. It was never successful commercially. You had to have such a big disk in order to get a reasonable size picture.

For instance, if you wanted a picture as large as you obtain from this tube you would need a disk some 8 or 10 feet in diameter, and that was a little inconvenient for the home. If you wanted even a small picture of 3 or 4 inches, you needed a disk 4 or 5 feet in diameter. And it operated at a very high speed, made a lot of noise, and took a lot of current to operate. And the reason we got into this business in 1931 was we felt if you could develop a reproducing device which had no mechanical moving parts, which could be made relatively cheap and would last for a long period of time, you could make television practical. And until this tube was developed, it was something that could be done in the laboratory but it was so expensive the average person could not afford it. In other words, where we came into the picture was after this work had been done on the mechanical system and everybody had pretty much decided that if that was the way you had to do it you were not going to have any commercial television.

Mr. SCOLL. I take it in your judgment television is a field in which there will be a great deal of further expansion?

Dr. DU MONT. That is correct.

Mr. SCOLL. That is, it has a great future?

Dr. DU MONT. That is right.

Mr. SCOLL. Do you contemplate, therefore, that it may be necessary for you to undertake some further expansion?

Dr. DU MONT. Well, I think undoubtedly that is true. In the last 2 years we have spent a lot of money in setting up new plants and new equipment. We moved into those plants this year. We have a new tube plant of about 200,000 square feet, and a new receiver plant of 500,000 square feet. And that is going to take care of us probably for another year only. And then we will have to be thinking about further expansion.

Mr. SCOLL. Have you been giving any thought to how you will finance that expansion?

Dr. DU MONT. We are hoping that we can finance it out of profits. It looks like we will be able to do that.

Mr. SCOLL. Out of retained earnings?

Dr. DU MONT. That is right.

Mr. SCOLL. So that you do not contemplate any further common stock financing?

Dr. Du Mont. Not in the immediate future, but I would not want to promise that we indefinitely would not need it. It is hard to tell. Right at the moment it does not look like we will need any.

Mr. Scoll. If you were to require common stock financing, have you given much thought to what many of the witnesses already have testified to, that it is difficult to get equity capital, or do you expect you will have any difficulty in that respect?

Dr. Du Mont. I think a lot depends on getting your equity capital when you are able to get it.

I might point out that actually in some cases we have obtained this equity capital not when we needed it but before we needed it. In other words, when the market was good and we knew we were going to need it later, we went ahead and got it. And I know equity financing has been poor in the past. Sometimes you could just forget about getting it. Right now is not particularly a good time to get it, but who knows what it will be a year from now.

Mr. Herter. In your 1948 issue of preferred stock, when you sold roughly $3,000,000 worth, it cost you $355,000 to get that?

Dr. Du Mont. That is right.

Mr. Herter. In other words, you had to pay better than 10 percent?

Dr. Du Mont. That is right.

Mr. Herter. In order to get that money?

Dr. Du Mont. It would have been more if we tried to get it in the common.

Mr. Herter. For the common?

Dr. Du Mont. Yes.

Mr. Herter. I imagine that is true. At that time you apparently made up your mind it was worth doing it on that basis rather than leaning on your line of bank credit?

Dr. Du Mont. That is right.

Mr. Scoll. Is long-term credit open to you?

Dr. Du Mont. We have this 3½ million which is a 2-year proposition. It is shown under loans and it is marked "Bank credit available by agreement."

We have at various times discussed long term, but the restrictions they wanted to put on it were such that we would rather not have it.

Mr. Scoll. Would you mind explaining a little further on that point?

Dr. Du Mont. Well, I do not recollect at the moment exactly what the restrictions were, except that we had to keep certain balances, ratios, and things like that, and, it seemed to us we could not be sure of maintaining these over a long period of time. I do not remember all the details but I do know after we looked it over it did not seem very satisfactory on the long-term deal. In other words, you would not be as free to move as you are now. We practically have very, very few restrictions in our operations today.

Mr. Scoll. So that you preferred, and I presume you still prefer, if you need to go to the public for expansion money to finance by stock issues rather than through loans even though stock financing is more expensive, because of the relative freedom of operations?

Dr. Du Mont. That is right.

I remember now one of the restrictions in some of the loans was that we could not go ahead, for instance, and spend over a certain amount for capital improvements. If that had been in effect the last year or two we would have been just out of luck; we just could not have anything like that in there. There is a perfectly good reason why they would put that in a long-term loan, but you are not restricted when you have equity capital from common stock, and so forth, in those moves.

Mr. SCOLL. So that you balance off the increased cost of equity capital against the restrictions you would have to put up with if you fianced through long-term loans?

Dr. DU MONT. That is right. We can make up the excess cost. I mean the point is we can make good use of the money, more than what the additional cost to get it is.

Mr. SCOLL. I do not want to labor the point, but I think it is worth emphasizing. So that the lower cost of credit financing is not the only consideration that you have to give when you are determining how to raise money for expansion?

Dr. DU MONT. Not in a rapidly expanding business. No; I would not say it is.

The CHAIRMAN. What is your conclusion from that, Mr. Scoll?

Mr. SCOLL. I have no conclusion, sir, I just wanted to get Dr. Du Mont's conclusion on the record.

Dr. DU MONT. My only conclusion is that we can do a lot more with the funds at a slightly higher cost of getting them without restrictions than we can with saving some money on the actual charges of funds that are restricted as to how we can use them.

Mr. HERTER. Under your earnings statement here you could have done a considerable portion of your expansion financing out of earnings, could you not?

Dr. DU MONT. That is correct. But one thing I think has allowed us to move along the way we have is the fact that we have always tried to keep our balance sheet so it was a relatively good balance sheet. In other words, when you go to the bankers and you have to have money, when you are in a position that you can turn them down if the deal is not good enough, your financial position is such you can carry right along regardless. And one thing we have done over this period is that we have not expanded until we have had the money to expand. In other words, we have waited until we received the money and then went ahead with expansion.

Where you get into trouble is assuming you are going to get it and you go ahead and you get stuck with it.

Mr. HERTER. I think you said yourself that you anticipated your future needs?

Dr. DU MONT. That is right.

Mr. HERTER. And sold stock when the market was good?

Dr. DU MONT. That is right. There are plenty of times during this period that we had a terrible time getting common stocks sold. We just have to pick the spot. For some reason it is good or it is bad.

Mr. SCOLL. Did you ever have occasion to consider obtaining a long-term loan from a life-insurance company?

Dr. DU MONT. Yes; some of those loans—when you asked me that question, it was with a life-insurance company.

Mr. SCOLL. That you were considering?

Dr. DU MONT. We had been discussing a long-term loan.

Mr. SCOLL. What year was that?

Dr. Du Mont. We have discussed it at various times. I would say several years ago we discussed it, maybe 3 or 4 years ago; never in the early days. It is just in recent years we have discussed it. And in 1948 the convertible preferred that we received, we went ahead with that when we were not satisfied with the life-insurance arrangement.

The Chairman. What were these restrictions of which you were speaking? My attention was diverted by another matter.

Dr. Du Mont. I do not remember all the restrictions but I do remember one was that we were limited as to how much we could spend for capital expenses. And in our business, expanding as rapidly as it is, that is a pretty serious restriction—if our business doubles and we cannot go ahead and buy new equipment to take care of it. As you can see we have done it and we are still in good shape.

The Chairman. Does this mean that in an expanding business such as yours, in a new enterprise, in a new field, you would much prefer to have equity capital, venture capital, than debt capital?

Dr. Du Mont. There is no question about it. If we were stabilized, then your insurance money would probably be all right; or if just increasing at a relatively slow rate, I do not think it would be any problem.

The Chairman. In other words, a new venture requires a very large freedom with respect to the use of the funds which are available?

Dr. Du Mont. That is right.

The Chairman. Now you testified here a moment ago in response to Congressman Herter about the very low value at which you set up your patent rights on your books. As I recall it, your answer was those figures represent fees to the Patent Office and lawyers' expenses.

Dr. Du Mont. That is right.

The Chairman. And you have not attempted to capitalize those patents?

Dr. Du Mont. No.

The Chairman. How many competitors do you have in the field of science in which these patents are being issued?

Dr. Du Mont. There are about 100 companies manufacturing television receivers, cathode ray tubes, cathode ray oscillographs, and transmitters. And probably there is only somewhere around four or five of those that do much development work. The bulk of the other companies are licensed to a large extent through RCA patents and some of them through our patents. We are gradually getting more and more.

The Chairman. Are these patents exchanged in the industry?

Dr. Du Mont. Not generally; no. By and large, RCA has a patent pool, and if you take a license from RCA, they have made arrangements with the telephone company, General Electric, Westinghouse, Farnsworth. In other words, they have practically all the patents in that one pool except our patents. We have not made any arrangement with RCA and we operate separately.

The Chairman. Do they need any of the patents which you have and do you need any of the patents which they have to operate?

Dr. Du Mont. I do not like to say we need any of their patents, but we say they need some of our patents. And some of these sums we show here——

The Chairman. Let me put the question this way: How many of these inventions in the field of television have now become part of the public domain, so to speak, in the field of invention?

Dr. Du Mont. I would not really know how to answer your question.

The Chairman. How about this cathode tube?

Dr. Du Mont. A lot of the basic patents, there is not any question, have run out long ago. However, there are a number of improvement patents that still remain, specific improvements, which, unless you use them, you are at a very definite disadvantage in trying to compete.

Mr. Herter. Are there any basic patents on the cathode-ray tube?

Dr. Du Mont. Yes. I know we have alone 75 or so patents on the cathode-ray tube. Other people can make tubes without using those patents.

Mr. Herter. They can?

Dr. Du Mont. Yes; but it is a question as to whether they have as good a tube when they are finished with it.

Mr. Herter. Insofar as licensing is concerned, have you a standard fee for licensing which anybody can pay and be licensed, or can you pick your customers?

Dr. Du Mont. No; we license anybody.

Mr. Herter. Anybody on a standard basis?

Dr. Du Mont. That is right.

The Chairman. Have you run across any trouble from the so-called umbrella patents that have developed in other industries? Some years ago when a congressional committee was looking into the patent problem it turned out that it was a familiar practice in some industries to patent an improvement upon an old device in such a manner that it was hoped that the new patent on the improvement would prevent a utilization of the old without the payment of royalties.

Dr. Du Mont. Well, I think the question is probably a little broader than that. I do not know of any specific instances of what you mentioned. However, we are in disagreement with RCA on the question of patents.

In this patent column some of these amounts were received previously from RCA. But as of the present time we have not been able to get together, and they have sued us on their patents and we have sued them on our patents. And we just have not been able to get together on the amount to be exchanged or received one way or the other.

Mr. Scoll. Dr. Du Mont, were patent questions and the situation in the art, as far as who held what patent, factors which affected your financing of the company at any time during this period?

Dr. Du Mont. I think they may have had some bearing on it. I think the fact that we made cathode-ray tubes for 5 years before RCA started did not put us in a bad position. In other words, it was not a question of us copying RCA, which has usually been the case in the radio industry.

Then, as far as cathode-ray oscillographs are concerned, we made those before RCA, and even television receivers we had out 6 or 7 months before RCA put them on the market. In other words, we have not been in the position of one copying other people but we have been in the position that we brought it out first and other people have followed along the line that we have developed.

On the cathode-ray tube, the general policy of the other manufacturers was not to make any larger than 10-inch cathode-ray tubes, and if they wanted a picture bigger than 10 inches, they used a projection tube. We did not like that because we did not think the picture was bright enough or clear enough, and we made 12-, 15-, and 19-inch tubes. And by and large the industry now is making 12- and 15-inch tubes, the same way we are. They tried not to do it for several years and it was too tough competition.

And I presume this 19-inch tube next year, why, the industry will follow that. So we have not been in the position as far as patents or anything else is concerned where we waited for the other fellow to do something and copied him. It has helped us in dealing with these financial people. They have been interested that we have had patents and have had a lot of the material out first where we were just not copying what somebody else did.

Mr. Scoll. Now the television industry, at least its televising activities, no, activities are under the jurisdiction of the Federal Communications Commission. Does that have any bearing or effect on the type of equipment which you can manufacture and sell for use in video?

Dr. Du Mont. It is obvious, if you are going to have a system of television which is of the utmost use to the public, that you have to standardize. Every station should transmit on the same standards so that anybody's receiver can receive that. If one station transmitted 500 lines and the next one 400, you would have to have a separate receiver for each station. So that one of the functions of the Federal Communications Commission is to arrive at the best standards for the public, and then every station must transmit on those standards. And that allows the manufacturers to make a receiver which can receive from any station.

So that the rules and regulations of the FCC are very vital to the industry. But at the present time there happens to be a hold-up on the granting of new transmitting stations. There has not been a single transmitting station granted in 15 months now.

The allocation of the stations throughout the country was such that there was certain interference between some of the cities where they were allocated a little too close together. For instance, Cleveland and Detroit are examples. And the granting of licenses was held up 15 months ago, and it was supposed they were only going to be held up 3 or 4 months. But it has dragged on and on because the color question has been thrown into the problem.

If you notice in 1949, for instance, on exhibit 1, where we show profit and loss, we have not been able to maintain the ratio of profit in 1949 we did in 1948 because we had to shut our transmitter division down of 400 or 500 people this year. We could not make transmitters if the Government is not going to let us put them up. So, it does have a very big effect on business.

Mr. Scoll. If I may summarize your statement, then: Your expansion, certainly as far as the broadcasting equipment is concerned, the manufacture of broadcast equipment is controlled by the activities of the Federal Communications Commission in licensing stations or in licensing equipment for use?

Dr. Du Mont. That is right.

Mr. Scoll. Now, did you have that same factor to encounter in the period when you were developing your scanning device?

Dr. Du Mont. The art was not sufficiently developed to set standards. You see we started off in 1931, and we only had 60 lines in the picture. And from 1931 until 1941 we put them in gradually, 120 lines, 240 lines, 343 lines, 441, and finally 525 lines in the picture. Nobody was thoroughly satisfied with the picture until we arrived at that point; then everybody agreed on it, and the Commission standardized. That was in 1941.

In other words, our business from 1931 to 1941 was with very little television in there. You were spending a lot of money experimenting on it, but you were not getting any income to speak of back from that money.

Mr. Scoll. I want to go back for a minute to your financing during the first 10 years of your existence of the company.

It appears that during most of that time your financing was largely accomplished by retained earnings until you put out a successful, or got some successful, financing in 1939. Would you care to comment in any way as to the impact of the Federal income taxes during that period on your ability to finance yourself? Did it help you or did it hinder you in any way, the various forms of business taxes?

Dr. Du Mont. I think as a matter of fact, from 1931, let's take through to 1938, the time you mention, well, I do not think we had enough profits in the business to make much difference one way or the other. There was no question, during that period of time, we were just struggling and just getting by.

And the amount of money that we made during that period was just about a break-even. We did not make any substantial sums from 1931 to 1936. It is practically a break-even there. We were just continuing the business on that basis, hoping that someday the thing would develop commercially.

Taxes, I do not think, had much bearing on that period because we were not making any money.

Mr. Scoll. Your decisions or your judgment with respect to methods of financing your capital expansion today, are they influenced by tax considerations primarily, or do you find that you can do business under the provisions of the Federal Internal Revenue Code without too much difficulty?

Dr. Du Mont. Well, I think I would have a little difficult job on the basis of the figures to argue against it, that we have not been able to do business. We have been able to make out reasonably well.

There is some difficulty when you are expanding as rapidly as we are and you have a lot of capital equipment to get, both the machinery and plants. If you could depreciate some of that more rapidly, it would make it easier to finance the expansions. You always have to be very careful on just how fast you can go, because you only have a certain amount of funds available for that.

Your depreciation rate for buildings is 40 years, or something like that, or even more, and a lot of your equipment is 20 years. So, you do not have a very large figure, which helps you when you care to expand.

Mr. Scoll. What you are saying is that, if the Treasury depreciation rates were more liberal on some forms of capital equipment, it would help you in financing your expansion; is that it?

Dr. Du Mont. In our particular case, yes; that is true.

Mr. SCOLL. Now, have you any particular types of capital equipment in mind that would be affected by more accelerated depreciation rates?

Dr. DU MONT. Take the type of equipment we use in our plants, in other words, the production machinery for manufacture of cathode-ray tubes. And there is a certain amount of that in the manufacture of receivers.

Mr. SCOLL. What depreciation rates are you now allowed on such equipment?

Dr. DU MONT. I do not know as I can give you that offhand, but I imagine it is somewhere in the neighborhood of 10 to 20 years, somewhere around that.

Mr. SCOLL. What sort of depreciation do you have in mind when you say you believe a more flexible treatment of depreciation would help you?

Dr. DU MONT. Well, a shorter interval, somewhere around half of the time that I mentioned there, would be very helpful.

Now, on the broadcasting equipment, the Treasury Department does allow rapid depreciation on that. I believe it is either 4 or 5 years we can write our broadcasting equipment off in. They allow that but not in the factory equipment.

Mr. SCOLL. By factory equipment, do you mean machinery and tools that are used in the manufacture of broadcasting equipment and receiving equipment?

Dr. DU MONT. That is correct.

The CHAIRMAN. Do you have any questions?

Mr. HERTER. No.

The CHAIRMAN. Dr. Kreps?

Mr. KREPS. I have no questions.

Mr. HERTER. Off the record.

(Discussion off the record.)

The CHAIRMAN. Would you say, Dr. Du Mont, that the figures which you have given to us this morning would indicate a new business which has a product in which the public is interested, and which can be manufactured efficiently, need not suffer for lack of equity capital?

Dr. DU MONT. Well, I certainly would agree with you that was the condition while we were developing this business. I have not tried to get any recently. I assume that one of these days you probably can get some more if you need it. I do not think it is a cut-and-dried proposition; that, just if a company has something that the public wants, necessarily you can go out and finance it. I mean I think there are a lot of other conditions in connection with it that determine whether you can get it or not. One is the condition of the market. Of course, other things are the record of the company up to the time they try to get the financing and so forth.

The CHAIRMAN. Well, during the past 20 years there have been many new products brought on the market as the result of research.

Dr. DU MONT. That is right.

The CHAIRMAN. As a result of the development of technology and of science in different fields, there are many businesses now which were utterly unknown 25 years ago.

Dr. DU MONT. That is right.

The CHAIRMAN. There has been a tremendous development, let us say, of the plastic industry—apparently profitably.

Ten years ago, when a committee of Congress was looking generally into this field, it seemed to be the case then that where a new product, which served a public interest and aroused the desire of the public for ownership, seemed to be capable of being manufactured at a profit, there was not very much trouble about getting equity capital.

Dr. DU MONT. I do not think there is any question that you can still go out today and, if you have something that is good enough, can get equity capital to finance it.

I think there is a difference between the time when we started in 1931 and as of today, where it certainly is more difficult for a person starting in to accumulate capital. I mean if he starts as an individual here. In 1931 the tax rates—you really did not even have to think about them.

The CHAIRMAN. How did you happen to hit upon this plan of A and B stock by which the owners of the B stock were given a certain voice in the management of the company but not sufficient voice to take over control? The old practice, of course, was to issue one stock completely without any voting rights of any kind at all.

Dr. DU MONT. The reason we worked it out that way, as far as I was concerned and the people that were interested in the A stock, they definitely would not turn over operating control to this other group. And yet we felt that they had a perfect right if we went and spent the money foolishly to have a say in it, which they did at the start—they had a 50–50.

And then some years after that it was changed to a 5 to 3 arrangement, where the amount they had put in was relatively small compared to the total amount. So they can't vote down anything today.

The CHAIRMAN. Was this plan a Du Mont development?

Dr. DU MONT. It was a plan that we worked out in connection with our legal people.

The CHAIRMAN. In other words, it was not copied from any other corporation that you knew about?

Dr. DU MONT. Not that we know of. Undoubtedly, there may be other companies we do not know of.

The CHAIRMAN. Of course, the testimony of small-business representatives who came before this committee was generally to the effect that the owners of the small business do not want to share the ownership; they do not want to lose control if they think they have an enterprise that will produce profit. So, they are not willing to surrender control for the mere purpose of getting capital. And, therefore, many of them would prefer to have debt capital rather than to have equity capital.

One frequently hears complaints from the financial centers that people will not buy common stocks in the markets even in the case of mature companies with sound earning records. I have often wondered if the reluctance of the ordinary owner of savings to put money into common stock does not arise from the complete absence of any practical manner of sharing in the control of the fund after it has been raised.

You have offered a method of sharing control so that your B stockholders, while they were willing to purchase your management skill by allowing you to retain the control of the company, nevertheless were willing to go in because you gave them a voice.

Dr. Du Mont. That is right.

The Chairman. That might be worthy of consideration by some of our people who complain about the reluctance of the masses of the people to put their savings into common stocks of corporations in which there is no sharing by management of responsibility and control.

Dr. Du Mont. Yes, sir; it is a big problem. Of course, in bringing a business like this up, I am looking at it from the management standpoint and my own standpoint. But you can get, lots of times, financing quite easy. All kinds of people will come in and take 51 percent. And that financing is usually available quite often. But the minute you do, of course, you fade out of the picture and it is a question of whether without somebody that has carried it along to this point it would be as successful from that point on.

By and large over this period we have been able to, whether we have done good or bad, we have at least had control of the thing and directed it.

The Chairman. What State is your company chartered in?

Dr. Du Mont. Delaware.

The Chairman. Any other questions?

We are very much indebted to you, Dr. Du Mont, for a very interesting morning.

This afternoon the witness will be who, Mr. Scoll?

Mr. Scoll. The representatives of the American Research and Development Corp., which is a new corporation formed for the purpose of financing new enterprises and providing venture capital to technological improvements.

Mr. Herter. And also a Massachusetts corporation.

Mr. Scoll. Also a Massachusetts corporation.

The Chairman. The committee will stand in recess until 2:30.

(Whereupon, at 12:10 p. m., the committee adjourned, to reconvene at 2:30 p. m., of the same day.)

AFTERNOON SESSION

(Present: Senators O'Mahoney (chairman) and Flanders, and Representative Herter.)

The Chairman. The hearing will be in order.

Mr. Scoll, who is the first witness this afternoon?

Mr. Scoll. Mr. Chairman, we have invited representatives of the American Research and Development Corp. to appear this afternoon to give the committee an appreciation of the development of the American Research and Development Corp., its functions, and how it was financed.

That corporation, as the committee well knows, is engaged in the financing of new technological projects.

We have as our first witness Mr. Merrill Griswold, who is one of the founders of the American Research and Development Corp. and is a member of its executive committee.

The Chairman. Mr. Griswold, would you be good enough to take the stand?

Mr. Griswold. Yes, sir.

The CHAIRMAN. We appreciate very much the fact that you are willing to come before the committee and make this contribution of your experience and good advice.

STATEMENT OF MERRILL GRISWOLD, MEMBER OF THE EXECUTIVE COMMITTEE OF THE BOARD OF DIRECTORS, AMERICAN RESEARCH & DEVELOPMENT CORP.

Mr. GRISWOLD. I am a member of the executive committee of the board of directors, American Research & Development Corp. My principal occupation is chairman of the board of trustees of Massachusetts Investors Trust which is a stockholder in American Research & Development Corp.

Mr. Ralph E. Flanders, United States Senator from Vermont, a director of the company and its first president, summarized the need for such an organization as American Research & Development Corp. as follows:

> As president of the Federal Reserve Bank of Boston, I became seriously concerned with the increasing degree to which the liquid wealth of the Nation is tending to concentrate in fiduciary hands. This in itself is a natural process, but it does make it more and more difficult as time goes on to finance new undertakings.
>
> The postwar prosperity of America depends in a large measure on finding financial support for that comparatively small percentage of new ideas and developments which give promise of expanded production and employment, and an increased standard of living for the American people. We cannot float along indefinitely on the enterprise and vision of preceding generations.
>
> To be confident that we are in an expanding, instead of a static or frozen economy, we must have a reasonably high birth rate of new undertakings.
>
> There are in particular two large-scale repositories of wealth which have a stake in the Nation's future and who should be concerned with a healthy basis for the prosperity of these postwar years. These two groups are the life-insurance companies and investment trusts.
>
> A project on which we have been making excellent progress in the last few months is for a development corporation financed in a large measure by these two groups of institutions, under the directorship and management of the most capable men available in the fields of business and technology.

The percentage of over-all wealth of the United States held in fiduciary hands is very high indeed. For example, in New England today 45 percent of the wealth is in fiduciary hands, such as trustees, trust companies, investment companies, insurance companies, savings banks, colleges, and other educational institutions, foundations, et cetera. There is no reason to believe that in the rest of this country substantially different conditions obtain. Heretofore, such sources of wealth could only be regarded as frozen, as far as investments in other than standard high-grade investments are concerned. Furthermore, wealthy individuals who formerly were often disposed to use part of their savings for venture capital, now find it necessary to use practically all of their savings in paying Federal income taxes, so that they are no longer so disposed to make venture-capital investments.

American Research & Development Corp. was organized in 1946 under the laws of Massachusetts as a closed-end investment company under section 12 (d) (1) of the Investment Company Act of 1940. It was formed to engage primarily in the conduct or development of new enterprises, processes or products, or the further development of existing processes or products. By its charter the company cannot invest in any company engaged in a new enterprise unless research or development work "indicate that the product or process to which the new enterprise relates is commercially practicable and embraces prospects of ultimate profit."

Recent advances and discoveries in the arts and sciences portend an area of new devices, processes, and products which will undoubtedly lead to new enterprises and the recasting of old ones. Because of the risks inherent in the development of new products and enterprises and in the revamping of old businesses, students of finance and the sciences and Government officials had repeatedly pointed to the necessity of attracting what is commonly referred to as venture or risk capital for the fullest exploitation of such new advances. It has been urged, from time to time, that institutional investors such as insurance companies, investment companies, research, endowed, and other organizations and individuals controlling large pools of capital should, by their joint efforts, furnish the necessary capital and, at the same time, so spread the risk as to minimize its effect upon any one source of capital.

In 1946 discussions along those lines among a group of men, prominent in finance, education, and science in New England, led to the formation of American Research & Development Corp.

Among the persons who participated in these discussions were:

Dean Donald K. David of the Harvard Graduate School of Business Administration.

Dr. Karl T. Compton, then president of the Massachusetts Institute of Technology and until recently chairman, Research and Development Board, National Military Establishment, Washington.

Ralph E. Flanders, then president of the Federal Reserve Bank of Boston, now United States Senator from Vermont.

Bradley Dewey, president, Dewey & Almy Chemical Co.

Frederick S. Blackall, Jr., president, the Taft-Peirce Manufacturing Co., and formerly president of the New England Council.

And I also took part on account of my connection with Massachusetts Investors Trust.

The business of American Research & Development Corp. is managed by a board of directors consisting principally of businessmen interested in encouraging the promotion of new enterprises, and a board of technological advisers, which acts in a consultative capacity.

The board of directors consists of a number of the above names and other businessmen interested in venture capital, including:

Paul F. Clark, president, John Hancock Mutual Life Insurance Co.

Eugene M. Geddes, partner, Clark, Dodge & Co.

Lessing J. Rosenwald, chairman, Lessing Rosenwald Foundation.

The president of the company is Brig. Gen. Georges F. Doriot, long on the staff of the Harvard Graduate School of Business Administration and, during the war, Director of Military Planning, Office of the Quartermaster General, and Deputy Director of Research and Development Division of the War Department General Staff.

The CHAIRMAN. He did a very good piece of work there, I have occasion to testify personally, because I observed a great deal of it as a member of the Appropriations Committee.

Mr. GRISWOLD. He will be pleased to have that repeated.

The advisory board consists of the following:

Dr. Karl T. Compton.

Dr. Edwin R. Gilliland, professor, department of chemical engineering, Massachusetts Institute of Technology.

Incidentally, Mr. Gilliland was Assistant Rubber Director during the war, and Bradley Dewey, who is one of the directors, was Rubber Director.

Mr. Jerome C. Hunsaker, head, department of aeronautical engineering, Massachusetts Institute of Technology.

The company is national in its scope and a beginning has been made in the creation of regional advisory boards in different areas in the country, starting with Cleveland and Philadelphia. Similar boards are also planned for Pittsburgh, Houston, Chicago, and the west coast. This was deemed desirable as the projects which the company has financed are located all over the United States—in New England, Ohio, California, Texas, Mississippi, and the South Pacific.

American Research & Development Corp. has 484 stockholders. Institutional investors in the company now include the following:

John Hancock Mutual Life Insurance Co., Boston.
State Mutual Life Assurance Co., Worcester.
The Home Insurance Co., New York.
*Commonwealth International Corp., Ltd., Montreal.
Consolidated Investment Trust, Boston.
Graham Newman Corp., New York.
*Investors Mutual Trust, Minneapolis.
*Massachusetts Investors Second Fund, Inc., Boston.
*Massachusetts Investors Trust, Boston.
North American Investment Corp., San Francisco.
Overseas Securities Co., Inc., New York.
Massachusetts Institute of Technology, Cambridge.
Rice Institute, Houston.
University of Pennsylvania, Philadelphia.
University of Rochester, Rochester.
Lessing Rosenwald Foundation, New York.

Of those eight investment companies mentioned, the four of them with the asterisks are open-end and four of them are closed-end investment companies.

The capital of the company is now $4,436,000, which was raised by the sale of 176,095 shares at $25 per share. On December 1, 1949, the company had $1,800,00 in cash, Government bonds, and commercial paper. The balance of its capital was invested in 13 different enterprises and 3 more investments have been approved for early action. In some of these enterprises American Research & Development Corp. has provided all the new capital, but in a number of cases it has been instrumental in enlisting additional new capital from other sources as well.

It may be of interest that in the cases of three highly specialized new enterprises, employing very modern and unique developments in technology, in the financing of which American Research & Development Corp. has participated, the annual sales volume is already running at the rate of $3,000,000 and the number of employees is in excess of 400.

Those are three of our small companies which are located in Boston or Cambridge right near us. And the pay roll of these three companies alone is probably running now between a million and a half and $2,000,000 a year.

Mr. HERTER. And they have been in existence only 2 years, or 3 years at the outside?

Mr. GRISWOLD. Three years at the outside, that is right.

In view of the participation in the financing of this corporation by institutional investors, it is felt that a brief summary of the legal rights of life insurance companies and investment companies to invest in this company might be presented; also that an explanation be made of the application of the Investment Company Act of 1940 to the situation; also with respect to the present tax barrier to wide participation in such a company by wealthy individual investors.

Legal rights of life insurance companies to make venture capital investments: As noted above, two life insurance companies in Massachusetts have invested in American Research & Development.

In Massachusetts life insurance companies can invest in stock under certain circumstances, provided they do not purchase more than 10 percent of the capital stock of a company.

As regards the laws of other States, the following may be of interest. Over 80 percent of the assets of life insurance companies are held by companies incorporated in the following 15 States, to wit: California, Connecticut, Illinois, Indiana, Iowa, Massachusetts, Missouri, New Jersey, New York, Ohio, Pennsylvania, Tennessee, Vermont, Virginia, and Wisconsin.

As we read the statutes of these States it is legal for companies incorporated in the following States to invest in such a company as American Research & Development Corp.: Connecticut, Iowa, Pennsylvania, Wisconsin, and of course, Massachusetts.

In the rest of these 15 States it is illegal to invest in such a company as American Research & Development Corp.

Mr. SCOLL. May I interrupt for a second, Mr. Griswold?

Mr. GRISWOLD. Yes.

Mr. SCOLL. I presume from this statement thus far it is illegal for life-insurance companies incorporated in New York to invest in such enterprises?

Mr. GRISWOLD. That is correct.

Mr. SCOLL. Which would automatically exclude the New York-incorporated life-insurance companies?

Mr. GRISWOLD. That is correct.

Mr. SCOLL. When this matter was taken up with the insurance commissioner in the State of Massachusetts, did you encounter any resistance as to approval for life-insurance companies of Massachusetts to invest in American Research?

Mr. GRISWOLD. It was considered a very novel idea. And John Hancock and the State Mutual, which came in, wanted to be very sure that they would not be criticized by the insurance authorities. And we accordingly took the matter up with Mr. Harrington who was then, and still is, insurance commissioner, and we were agreeably pleased when he said he would not only have no objection but would look with great favor on Masschusetts companies investing in American Research.

Mr. HERTER. I have one question in connection with the Massachusetts law. Can a life-insurance company invest as much as it likes of its assets in common stock provided it does not invest in more than 9.9 percent of any one company?

Mr. GRISWOLD. I am coming to that. As I understand the law, you must invest your capital and three-quarters of your legeal reserves in restricted investments. But there is no applicable limitation with regard to one-quarter of your reserves and all of your surplus.

Mr. SCOLL. This is Massachusetts you are speaking of?

Mr. GRISWOLD. That is Massachusetts.

Mr. SCOLL. And the same does not hold true in New York, does it?

Mr. GRISWOLD. No. They cannot invest in common stocks in New York.

Mr. SCOLL. So, generally speaking, the fact that it is illegal for New York insurance companies to make such investments is rather a serious handicap to the spread of this idea, is it not?

Mr. GRISWOLD. Yes.

The CHAIRMAN. One-fourth of what sum is allowed to be invested without restriction?

Mr. GRISWOLD. All of your capital, Senator, must be invested in restricted investments?

The CHAIRMAN. Yes.

Mr. GRISWOLD. And three-quarters of your reserve. But your surplus and one-quarter of your reserves is free.

The CHAIRMAN. Except that not more than 10 percent of any particular stock can be invested in?

Mr. GRISWOLD. You cannot invest in more than 10 percent of a particular stock.

Mr. HERTER. That is 10 percent of a stock of a company?

Mr. GRISWOLD. John Hancock could buy 10 percent of American Research. They could not buy 11 percent.

Mr. HERTER. Is that to avoid management problems or any accusation of dominating the management of a company?

Mr. GRISWOLD. I presume these 10-percent laws both for investment companies and insurance companies are very general, and as a general proposition none of those institutions are allowed to buy more than 10 percent in any one company. Investment companies cannot either.

The CHAIRMAN. That might be a very great deal in certain types of companies. Ten percent of American Telephone & Telegraph would be a pretty substantial block of stock.

Mr. GRISWOLD. I fancy it would.

Mr. SCOLL. Mr. Griswold, your list of insurance companies which are investors in American Research & Development Corp. includes the Home Insurance Co. of New York?

Mr. GRISWOLD. That is not a life-insurance company; that is a fire-insurance company. Or I think it is. It is not a life-insurance company.

Mr. SCOLL. Has the question of investment in American Research & Development Corp. ever been put to any other insurance commissioners outside of Massachusetts?

Mr. GRISWOLD. Yes; we put the matter up to the companies in Connecticut. And I remember very well a luncheon was given to Mr. Flanders, Mr. Compton, and Mr. David, of the Business School. They were all invited and showed considerable interest, but they have not yet invested any money in American Research.

Mr. SCOLL. The Connecticut companies?

Mr. GRISWOLD. The Connecticut companies; yes.

Senator FLANDERS. My recollection is that the insurance commissioner of the State was quite favorable to the idea; is that right?

Mr. GRISWOLD. Mr. Allen, the insurance commissioner, was very disappointed when they did not go along.

The CHAIRMAN. Mr. Griswold, I was a little uncertain with respect to your submitting this matter to Commissioner Harrington, whether it was for the purpose of learning what his general attitude would be with respect to such an investment, or whether it was for the purpose of securing his support to recommend a change of the law. Did the law authorize the purchase at the time you approached him?

Mr. GRISWOLD. The law was perfectly clear that the life-insurance companies in Massachusetts could invest in common stock, whether dividend-paying stocks or not. But life-insurance companies always hesitate to do anything which they think the insurance commissioner might criticize them for doing.

The CHAIRMAN. I just wanted to know how the insurance commissioner would enforce the law.

Mr. GRISWOLD. It is perfectly legal, but you can still criticize people when they are legal.

The CHAIRMAN. Yes; I have heard of that.

You may proceed, Mr. Griswold.

Mr. GRISWOLD. Connecticut, Ohio, and Wisconsin have a 5-percent rule which is variously phrased. Detailed information will be filed with the committee, if desired, regarding the laws of each of these 15 States.

The CHAIRMAN. I think it may well be filed with the committee, and reference will be made to it at the end of your testimony.

Mr. SCOLL. Could we have the document set out in the record at this point?

The CHAIRMAN. At the conclusion of his statement it will be set out in the record.

Mr. GRISWOLD. The State of New York is the most important State, and here it is illegal for a life-insurance company to invest in common stocks.

Federal law regarding investments in American Research & Development Corp. by investment companies:

At the time the Investment Company Act of 1940 was before the Congress it was felt by the Securities and Exchange Commission that the large pools held by investment companies might well be utilized to the benefit of registered investment companies, and in aid of the promotion of new or old enterprises by furnishing venture capital for such purposes.

According to the Securities and Exchange Commission, this had long been urged by economists as a proper function of investment companies. It was recognized by the Securities and Exchange Commission, however, that, as a practical matter, the management of an individual investment company, in the exercise of prudent judgment, might hesitate to undertake such efforts directly on any scale which could secure to it a return commensurate with the risks involved. In an effort to meet this problem and to encourage the promotion of such undertakings, section 12 (e) was drafted by the Securities and Exchange Commission and inserted by Congress into the act. It was necessary to place this section in the act because otherwise an investment company could not legally have purchased more than 3 percent of the voting stock of such a company as American Research & Development. Section 12 (e) specifically authorized registered investment companies to purchase securities of another corporation engaged in the business of underwriting, furnishing capital to industry, financing promotional enterprises, purchasing securities of issuers for which no ready market is in existence, and similar activities, provided that the aggregate cost of the securities of such corporation purchased by such registered investment company does not exceed 5 percent of the value of the total assets of such registered company. It was provided that the aggregate paid-in capital and surplus of such a venture-capital corporation should not exceed $100,000,000.

When the Securities and Exchange Commission approved the registration statement of American Research & Development, it limited the investment by any single investment company to a maximum of 9.9 percent of the shares of American Research & Development.

Section 12 (d) provides that if a venture-capital corporation is organized pursuant thereto, the stock can only be owned by investment companies. The Investment Company Act of 1940 provides, however, that the Securities and Exchange Commission can grant exemptions in certain cases.

When American Research & Development was organized it was felt desirable by the organizers of this company, and by the Securities and Exchange Commission, that other institutional investors, besides investment companies, such as insurance companies, educational institutions, foundations, et cetera, should also be allowed and encouraged to invest in this company and also private individuals. The Securities and Exchange Commission, therefore, granted an exemption permitting such participation, provided that at least $1,500,000 was subscribed by institutional investors of all kinds. The Securities and Exchange Commission stipulated that the company must start with a minimum capitalization of $3,000,000.

At the end hereof is appended a transcript, which may be of interest, of the discussion between David Schenker, of the Securities and Exchange Commission, and former Congressman Reece regarding the desirability of section 12 and regarding the failure of investment companies in the past to provide venture capital.

Mr. Scoll. May I interrupt you again, Mr. Griswold, at this point?

Mr. Griswold. Yes.

Mr. Scoll. Are the venture-capital investments made by American Research & Development Corp. the kind of investments which the Massachusetts Investors Trust would make ordinarily by itself?

Mr. Griswold. No, sir. I am chairman of Massachusetts Investors Trust, and they buy principally what are known as blue-chip stocks, or stocks listed on the New York Stock Exchange. We would under no circumstances directly make investments in risky new undertakings for the reason that we are not staffed for that purpose. We do not know anything about the technique of the thing, and we would probably end up by making fools of ourselves if we tried it.

We were, however, perfectly willing to invest in a company organized for that specific purpose which could be properly staffed with technological experts and businessmen who knew that kind of business. And we preferred, therefore, to do it indirectly.

The CHAIRMAN. I gather from your testimony that the Research & Development Corp. is owned by institutions and trusts and not by individuals.

Mr. GRISWOLD. Both.

The CHAIRMAN. There are individual stockholders?

Mr. GRISWOLD. Yes.

The CHAIRMAN. How many?

Mr. GRISWOLD. I should say about half the capital was owned by institutions in rather large amounts, and the other half was held by individuals in relatively smaller amounts, because the total number of stockholders, which I think I mentioned, is four hundred and something.

Mr. SCOLL. Mr. Griswold, you have stated that Massachusetts Investors Trust would not or could not invest directly in any of the underlying projects of American Research & Development Corp. Would you care to explain further on what basis Massachusetts Investors Trust, therefore, went into American Research & Development Corp.? What did you go into that project?

Mr. GRISWOLD. We figured that by investing in a company such as American Research, which was properly staffed, we would get diversification of this kind of investment. It is very risky to put money into a brand new project. Some of them are bound to fail. But if you secure diversification by buying 15 or 20 of those indirectly through a special company, it does not matter that four or five of them may fail because the others, the hope is, will more than make up for it.

Mr. SCOLL. Then it is your opinion that investments such as American Research are proper investments for fiduciary assets and funds?

Mr. GRISWOLD. It depends upon what kind of fiduciary assets you are talking about. Such a stock is a perfectly proper investment legally for an investment company; it is perfectly proper for life-insurance companies in certain States. But when you get to fiduciary money, it would certainly be improper for a trustee under a will to invest in American Research in my opinion. It would probably be all right for an educational institution to invest that kind of funds in it.

Mr. HERTER. You would not recommend it for a savings bank either, would you?

Mr. GRISWOLD. It would not be proper for a savings bank.

Mr. SCOLL. Do you have any idea of how much in dollar volume such qualified fiduciary assets might be available or are in existence, we will say, from which capital might be drawn for projects of this kind?

Mr. GRISWOLD. I looked that up myself the other day and I can quote another authority on the subject if you would like me to.

Mr. SCOLL. Yes.

Mr. GRISWOLD. I inquired about that and asked the opinion of a man named Mayo A. Shattuck, in Boston.

Mr. SCOLL. Who is he?

Mr. GRISWOLD. He is today a nationally known authority on trust law and trust administration. He has written the leading textbook on the subject, and he was the man who added a large number of States in adopting the uniform prudent-man rule of investments for trustees.

There are about 18 or more States today that allow a private trustee to invest in any securities which a prudent businessman might invest in. And he has drawn a great many of those statutes.

Every State either has the prudent-man rule or has the legal-list rule. New York is the principal exponent of the legal-list rule, and there you can only invest in certain specified kinds of securities—I am not familiar with the exact securities—which are principally debt obligations.

Mr. Shattuck said that he believed the trust assets held by banks and individual fiduciaries—by banks, he means national banks, trust companies principally—exceed $100,000,000,000 in the aggregate. He points out that this figure does not include the face value of hundreds of thousands of life-insurance policies held in trust throughout the country, nor the assets held by thousands of banks and individuals in agency and custodian accounts, nor the already tremendous pension-trust deposits which are constantly increasing, nor the endowment funds of educational institutions, religious bodies, charitable foundations, and lodges and fraternal orders.

The composite total, he thinks, would be a staggering amount. He estimates several times $100,000,000,000.

Mr. Scoll. I just thought we ought to bring it out and repeat it again in the record at this point, Mr. Chairman, because it serves to bear out the conclusion of Senator Flanders, which was quoted by Mr. Griswold, of the continued large accumulation of American wealth in the hands of fiduciaries.

Mr. Griswold. That figure does not include life insurance.

Mr. Scoll. Which is supplemental to what we already heard from the insurance executives last week.

Mr. Griswold. State regulations regarding right of investment companies to invest in venture-capital companies:

Prior to the formation of American Research & Development Corp., State blue-sky regulations in Ohio, New Hampshire, Minnesota, and Wisconsin made it illegal for open-end investment companies to buy stock in any corporation which had not been in existence at least 3 years. Therefore, no open-end investment company could have purchased stock in American Research & Development if its shares were qualified in any of these States.

All large investment companies have been qualified under the laws of every State.

Mr. Scoll. That is for the purpose of selling their securities in that State?

Mr. Griswold. Yes.

American Research & Development Corp. was successful in persuading the first three States mentioned to eliminate the 3-year requirement to the extent of 5 percent of the assets of any investment company. Wisconsin amended its regulations to permit such investments up to 2 percent of investment company assets.

In States other than these four there never were any restrictions and there never have been any restrictions regarding closed-end investment companies because closed-end companies are not engaged in selling shares to the public.

Mr. Herter. Mr. Chairman, I think this is a good point to describe the difference between the open-end and the closed-end company.

The Chairman. I think it would be.

Mr. GRISWOLD. I would be glad to do it.

Prior to 1924 all investment companies were closed-end investment companies. They raised their capital at one time, either common or preferred, or bonds, or however they were financed, and then they did not have to go to the public for more money, and they were under no obligation whatever to buy back the shares they issued.

In 1924 they invented open-end investment companies. The company of which I am chairman was the first to adopt that. The second company to do that was a well-known company in Boston called the State Street Investment Corp., and the third company was Incorporated Investors.

These companies were different in that they obligated themselves to buy back their own stock on demand at any time. So they are constantly redeeming their shares and issuing new shares, and there is a guaranteed market for them. And, as a result, all companies being formed today are open-end companies because they are very much more popular with the public. And those three companies have now gone to over a hundred companies, and the combined assets of the open-end companies are now about $1,800,000,000.

In recent years, and certainly since 1940, there have been no more closed-end companies formed, except maybe very, very few. And their capitalization has gone down.

I will put it another way: In 1940 the capital of the open-end companies was about one-half as great as the capital of the closed-end companies. Today the situation is exactly reversed and the capital of the open-end companies is about twice the combined capital of the closed-end companies.

The CHAIRMAN. That is since what year?

Mr. GRISWOLD. Since 1940. And these open-end companies are growing very rapidly, at a rate, I should say, of 300 million to 500 million dollars a year.

Mr. HERTER. Did you say from 200 to 500 million dollars a year?

Mr. GRISWOLD. From 300 to 500. Let us say from 300 to 400 million dollars a year.

Mr. HERTER. Is not your company among the largest?

Mr. GRISWOLD. Our company is the largest.

Mr. HERTER. It is the largest of that group?

Mr. GRISWOLD. Yes.

Investments by wealthy investors:

Many wealthy investors are not so much interested in the dividends that they will receive in the early stages on new investments as in the possibility of appreciation or realization of capital gains.

If such investors had a chance to make capital gains, which would be taxable as such, by using a venture capital company such as American Research & Development Corp., more capital for such a purpose would be forthcoming. However, if a venture-capital company realizes a capital gain by disposing of all or part of its interest in an enterprise, after its maturity, and if thereafter dividends are paid by such a company which were derived from such gains, a stockholder would pay a much higher tax than if he had realized the gains directly rather than indirectly through the venture-capital company.

This is because the venture-capital company would first pay a tax of 25 percent on such capital gains when it realized them. If it then distributed the remainder of such capital gains, that is, 75 percent, a stockholder in a high bracket would keep but little of the capital gains.

If, for instance, he was in the 80-percent bracket, another 60 percent, that is, 80 percent of 75 percent, would have to be paid over to the Treasury. This 60 percent added to the 25 percent already paid by the company totals 85 percent tax so that out of the capital gain, such an investor would retain only 15 percent.

While venture capital companies are technically investment companies, they do not qualify, under the Revenue Act, as regulated investment companies. The term "regulated investment company" is used in the income-tax law to refer only to such investment companies as qualify for special tax treatment under sections 361 and 362 of the Revenue Act. If an investment company so qualifies it is treated for tax purposes as a conduit. This means that it and its stockholders are treated as if the stockholders were the direct owners of the portfolio securities, provided the company distributes its entire net income, including capital gains, in the form of taxable dividends. To the extent that the dividends distributed consist of capital gains, the later are so reported to the stockholders and taxed to them as such. Their identity, therefore, as capital gains is not lost because they pass through the conduit and they are accordingly taxed at only half the regular rate—in any event at not more than 25 percent.

The reason that a venture-capital company cannot qualify under section 362 is the diversification requirements contained in section 361. Under this section the securities, other than Government securities owned, shall be limited in respect of any one issuer to not more than 10 percent of the outstanding voting securities of such issue.

While it is true that these restrictions apply only to 50 percent of the portfolio, nevertheless it would usually be difficult for a venture-capital company to qualify even for 50 percent of its portfolio. This is because such a company would ordinarily acquire more than 10 percent of the voting stock of a company which it financed.

Mr. SCOLL. At that point, Mr. Griswold, is it your position that companies like American Research & Development Corp. should be qualified to be treated as conduit companies? Is that your point?

Mr. GRISWOLD. Yes, sir; I think that a grave injustice is done at the present time. There is no reason that I know of why they should say that to get special tax treatment investment companies shall not own more than 10 percent of the stock of a company. I do not see what difference it makes. Investment companies, such as American Research, are fully as valuable in the public interest as ordinary open-end and closed-end investment companies.

Mr. SCOLL. So your objection is based then on the basis of an apparent discrimination against companies like the American Research & Development Corp.?

Mr. GRISWOLD. That is very important, and I think I had better go back to give you a slight history of the taxation. May I?

Mr. SCOLL. Please do.

Mr. GRISWOLD. In 1936 President Roosevelt recommended the passage of the undistributed-profits tax. There was a great deal of opposition by buisness to that tax, in many cases for pretty sound reasons. But the investment companies came forward and said that regardless of the merits of an undistributed-profits tax for ordinary business corporations, it was entirely satifactory and equitable for open-end investment companies, which was what they were considering at the time, because they were merely conduits between the investors and the ultimate corporations; and it was unjust to have double taxation; in fact, if there was double taxation it would make the operating expenses so high that the open-end investment companies could not function.

So the representatives of the industry went to Washington and talked the matter over with the Treasury Department, who agreed with them. But they said, "We would like to put various restrictions on this proposition of treating you as conduits."

And they thought up a half a dozen various rules about diversification. And I think they thought up a new regulation every day for a week.

Well, we did not mind any of these regulations because they were exactly in accordance with the way the industry was then functioning. So we did not object. And they put all these restrictions, including this 10-percent one, into the statute.

In my opinion it serves no useful purpose and ought to come out. And if it did come out, it would then become possible to interest wealthy individuals more easily in creating venture capital.

Mr. Scoll. Do you have any idea what the Treasury's views on such a change might be?

Mr. Griswold. I do not, but I offhand cannot see it would cost the Government anything at all to allow venture-capital companies in. Maybe there are better ways of doing it than I have suggested, namely, in striking out the 10-percent clause, but it would not hurt the Treasury to encourage venture-capital companies because there are not any venture capital companies to speak of that I know of.

Mr. Herter. May I ask you as a practical matter how that would work out with this particular Research & Development Corp.? You have invested in the common stock of some 13 to 15 companies. I have forgotten the exact number you gave here. Suppose one of them grows very rapidly, and because of your own holding you want to dispose of some of the stock of the company to the public. Presumably you have a capital-gains tax that is recorded at that time.

Mr. Griswold. Correct.

Mr. Herter. You would have to distribute that in the same year that it accrued, would you not, to your stockholders in order to get the benefit of the law at the present time?

Mr. Griswold. Yes.

Mr. Herter. Suppose in the following year one of these companies went bankrupt entirely, you would have no offset in there, and your own capital of the development company would be impaired by that amount and you would have no way of making up for it, would you?

Mr. Griswold. All I can say is that we have run open-end investment companies for 25 years and we have had no trouble. That is exactly what we do there. We make capital gains; we distribute them.

Mr. Herter. You distribute them and you cannot carry over any capital losses to offset against them?

Mr. Griswold. No. That would be very nice if we could. You can for 2 years, but it is not adequate.

The CHAIRMAN. Do I understand that your recommendation is there should be no limitation on the amount of stock which an investment company could invest in a venture-capital corporation?

Mr. GRISWOLD. No; you got me wrong.

Mr. HERTER. You might have a limit on your own investment trust but not on the amount it could have in any one company.

The CHAIRMAN. That is what I am trying to find out.

Mr. HERTER. There might be a limitation of 5 percent of your own assets, of 10 percent.

Mr. GRISWOLD. Under existing law we could not invest more than 5 percent of our assets in the American Research & Development Corp.

Mr. SCOLL. It is on the holdings.

Mr. GRISWOLD. The American Research & Development, when it invests in venture situations, usually puts up most of the money and acquires a great deal more than 10 percent of the voting stock. Therefore, it cannot qualify.

The CHAIRMAN. Is it your recommendation that the venture-capital corporation should be unlimited?

Mr. GRISWOLD. My recommendation is that a venture-capital corporation should be allowed to qualify as what is called a "regulated investment company" in the revenue act, the same as any other investment company can.

Mr. SCOLL. The same as Massachusetts Investors?

Mr. GRISWOLD. Yes.

Mr. HERTER. And act as a conduit again.

Mr. GRISWOLD. And be taxed on the conduit theory.

Senator FLANDERS. And have no limit as to the percentage of the ownership in the company it is financing?

Mr. GRISWOLD. That is right, because usually if we put up all the money or most of the money we get more than 10 percent of the voting stock.

Mr. SCOLL. By "we" you are speaking of American Research & Development Corp.?

Mr. GRISWOLD. That is right.

Mr. HERTER. Each of your subsidiary corporations would be paying normal corporation tax in any case?

Mr. GRISWOLD. We do not care about touching the taxation of the affiliated little companies. We do not need that. We would like to have it.

Mr. HERTER. It is merely the capital-gains provision and redistribution of earnings; is that it?

Mr. GRISWOLD. That is correct. So it will flow straight through from the affiliate company through the conduit to the stockholders, so that wealthy individuals can participate in this manner and make capital gains. Now a wealthy individual prefers to sacrifice diversification which he obtains through our company and make his investments direct because then he can have his capital gains treated as taxable at 25 percent.

The CHAIRMAN. There are two percentages, and I am not altogether certain whether you have made your record clear.

There is the percentage of the total funds of the investment company, and there is the percentage of the capital stock of the company in which it is investing. Am I right?

Mr. GRISWOLD. Let me start over again. There is a limit on the amount of stock of American Research which a company like Massachusetts Investors Trust, or for that matter a life-insurance company, would be allowed to buy. The most we would be allowed to buy would be 5 percent. The most that John Hancock could buy would be 10 percent of the capital.

Now you come to American Research——

Mr. SCOLL. You are talking now about buying stock in American Research?

Mr. GRISWOLD. Buying stock in American Research.

Mr. SCOLL. Yes. And now you are talking about the purchase of stock by American Research in the companies which it is financing?

Mr. GRISWOLD. Yes. I would like to correct that last part again. Both Massachusetts Investors Trust, being an investment company, and the John Hancock Life Insurance Co., being a life-insurance company, are allowed to invest in a venture-capital company up to just under 10 percent of its capital. We can each acquire 9.9 percent of the capital.

Now we come to American Research. There is no limit on what they can buy of any affiliate. They can buy the affiliate if they want to. But, if they acquire more than 10 percent of the stock of their affiliates, they cannot qualify for special tax treatment under the Revenue Act, with the result that American Research would have to pay a tax on any gains it made of 25 percent; and, if it distributed those gains, a wealthy individual who, let us say, was in the 80-percent bracket would get the remaining 75 percent from American Research and Development Corp. and then he would pay a tax of 80 percent on that. And by the time he got through he stands to win 15 percent net after taxes, and to lose 100 percent net if the thing goes wrong. And he could not deduct for his losses, only a thousand dollars, anyway.

The CHAIRMAN. Then, as I understand your recommendation, it is simply that a company like American Research should be permitted to buy as much as it pleases of the stock of any new enterprise which interests it and should be permitted to qualify under the Federal law just the same?

Mr. GRISWOLD. Correct.

Mr. SCOLL. Under section 361 of the Internal Revenue Code.

The CHAIRMAN. Yes.

Mr. GRISWOLD. Or, if there are any objections of the Treasury Department to that formula, they could undoubtedly work out some other formula which would give the company relief.

The CHAIRMAN. And you are telling this committee that, if that modification of section 361 of the code were permitted, more wealthy individuals would be likely to put their money into venture-capital companies like American Research?

Mr. GRISWOLD. Without any question, because we have had wealthy individuals who are properly advised make exhaustive inquiries into this subject and not invest in the company when they found out we could not qualify under section 361.

The CHAIRMAN. In other words, the result of that would be there would be an enlargement of the reservoir of savings available for investment in new enterprises?

Mr. GRISWOLD. Yes, sir; and it would cost the Treasury Department nothing because there are not any venture-capital companies to speak of now in existence.

Mr. HERTER. Except this one?

Mr. GRISWOLD. That is right.

Mr. HERTER. If the wealthy individual could be persuaded to buy a little percentage of the stock of each one of those companies that are held by the Research Co., then in the event of capital gains he would be taxed only 25 percent and could retain 75 percent?

Mr. GRISWOLD. That is true.

Mr. HERTER. But because they are lumped together under a certain holding company, if you want to call it that, he is penalized very heavily upon his gains?

Mr. GRISWOLD. Actually the wealthy individual does not usually have the facilities to research and investigate venture propositions that will be put up to him, and it can be done very much better by a company staffed for that purpose.

I would like to read you two short statements, one of which you may be familiar with.

One is by Thomas B. McCabe, Chairman of the Board of Governors of the Federal Reserve System, prepared at the request of a subcommittee of the Committee on Banking and Currency of the United States Senate, August 5, 1949:

> An illustration of the type of private financing company I have in mind, which I shall not mention by name, is a corporation which obtains money from insurance companies, trust funds, research and educational foundations, established investment companies, and individuals, and invests such funds in equities of new and established concerns that have some produce or process to be developed that is of scientific importance. Thus, the corporation provides a channel whereby equity risks can be pooled and financed, in part at least, by previously unavailable funds of fiduciary institutions.

The other statement is by Harry A. McDonald, Chairman, Securities and Exchange Commission, before the First Annual Mutual Fund Conference, New York City, on August 18, 1949:

> There are fewer and fewer around to invest in the new struggling outfit just getting on its feet. In due time, the widely recognized problem of risk capital will be put up to the insurance companies. This is a responsibility fund managers should take cognizance of.

Conclusion: The American Research & Development Corp. can accomplish its aims only through the realization of satisfactory profits.

A financially successful operation will enable this corporation to increase its investments in individual enterprises and will stimulate increased expenditures for research and development.

The American Research & Development Corp. believes that the rendering of assistance to successful new enterprises and small business represents an important contribution to the economic development of America.

(Additional data submitted by Mr. Griswold are as follows:)

The following discussion between David Schenker, counsel to the Investment Trust Study conducted by this Commission at the direction of the Congress, and former Congressman Reece appears on pages 113–114 of the transcript of the Hearings Before a Subcommittee of the Committee on Interstate and Foreign Commerce on H. R. 10065 (1940), Seventy-sixth Congress, third session.

"Mr. SCHENKER. * * * And, on page 55, we have made the provisions for a type of company which both the industry and we feel may be one of the most salutary provisions in this bill.

"Mr. REECE. To what extent have the companies engaged in the activity referred to in this subsection, heretofore?"

* * * * * * *

"Mr. SCHENKER. Venture- or risk-capital transactions?

"Mr. REECE. Yes.

"Mr. SCHENKER. We have made a study of that subject and found it to be negligible, absolutely negligible.

"What this bill attempts to do is this: In the past, investment companies—and that is particularly true of open-end companies where the certificate holder can compel the company to buy back his certificate at its asset value at any time, the companies had to be in liquid condition all of the time, because they cannot anticipate the extent of redemption demands they will have to meet. So, so far as the open-end companies are concerned, they have their funds invested almost entirely in blue-chip stocks or liquid securiites. They have to be in that position.

"Now with respect to the closed-end companies, where the stockholder does not have a right of redemption, our analysis indicates that they have not invested in venture situations * * *. We have been trying to encourage that activity.

"Mr. REECE. Have the companies indicated that they might be able to do this?

"Mr. SCHENKER. This provision has been inserted as a result of our studies and our talks with investment-company representatives. Here you have this tremendous pool of liquid capital that has not been effectively diverted into these channels of financing industry. This provision in this bill is to encourage this flow of capital in these channels.

"Mr. REECE. I think that is a good proposition, and I hope that the companies will be in a position to accomplish what you have in mind in putting it in.

"Mr. SCHENKER. Now, of course, I cannot make any promises; but I have every hope from my discussions and Judge Healy's discussions with these representatives, unless it has been terrifically complicated by this war situation—and I think that that will act a a stimulus rather than an impediment—I have every hope that immediately after the passage of this bill the larger investment companies are going to get together and create a substantial pool of venture capital by participating in the type of company for which this bill provides.

"Mr. REECE. If so, I think all of your labors will have been justified."

See also colloquy between David Schenker and Senator Wagner at page 1115 of the transcript of the Hearings Before a Subcommittee of the Committee on Banking and Currency on S. 3580 (1940), Seventy-sixth Congress, third session; Senate Report 1775 (1940), Seventy-sixth Congress, third session, pages 15–16; Jaretzki, The Investment Company Act of 1940 (26 Washington U. Law Quarterly 303, 326–7 (1941)).

The CHAIRMAN. Are there any particular suggestions that you would care to make with respect to the safeguarding of the creation of venture-investment corporations like American Research?

The Securities and Exchange Commission was established because, though there were many perfectly honest promoters and many sound corporations which were selling their stock to the public, there were at the same time many others whose principal purpose was to exploit those who had money to invest. And it was to protect against abuses that the SEC was established.

Now, are we sufficiently protected against the abuse of this very sound principle of creating venture-capital corporations?

Mr. GRISWOLD. In my opinion, no change whatever is needed in the Securities and Exchange Act as far as this sort of thing is concerned. And the attitude up to date of the officials of that Commission is entirely satisfactory and cooperative.

The CHAIRMAN. The act of 1940 is satisfactory so far as you wish to testify?

Mr. GRISWOLD. So far as this sort of thing is concerned, provided they always grant exemption orders in proper cases as they did in the case of this company. And I believe they will.

The CHAIRMAN. That is quite a proviso, Mr. Griswold, is it not? If exemptions are always to be granted, why should it be necessary to have any reason for exemptions? In other words, why not strike down that restriction?

Mr. SCOLL. You had better explain what you mean, what the exemption was about, Mr. Griswold.

Mr. GRISWOLD. I will put it this way: When the 1940 act was passed, it was a very complicated piece of legislation which it took weeks and months to get together. And it was impossible even for the investment companies or the SEC to think of everything that ought to go in and the possible exceptions that might later be necessary to be made. And they put clauses in the act allowing them to grant exemptions in meritorious cases in their discretion, when they were so disposed. And in drawing very complicated legislation like that you practically have to, or you find yourself in a strait-jacket.

The CHAIRMAN. Well, I have an inherent objection to too much discretionary power in any administrator.

Mr. GRISWOLD. I used to, myself, Senator, until I had seen some of these SEC acts operate. And they cannot draw them to cover every conceivable situation. And from time to time they have got to make exemptions, and the companies used to fight against it. I think now the companies have come to the conclusion, or some people have, that perhaps the SEC was right.

I can illustrate by saying when they passed the 1940 act the counsel for the industry went through and found 120, or some such number, of cases where they had discretion and they could make rules and regulations, and they could make exemptions, and they said just what you said.

So Senator Wagner said, "All right, sit down with the Commission and write your own law and see what you come up with." So counsel for both sides got together, and I got a great laugh because they had just about as many provisions and rules and regulations and exemptions and discretions as they did the first time.

The CHAIRMAN. That is very illuminating. May I ask you, Mr. Griswold, to amplify somewhat this statement at the beginning of your paper—that in New England today 45 percent of all the wealth is in fiduciary hands.

What is the reason for that in the first place?

Mr. GRISWOLD. No. 1: When people die in New England they leave their property in trusts very commonly, and they are doing so increasingly all over the United States. And when property is left in trust, it is improper for trustees to gamble with the money and, therefore, they will not and should not buy stock in venture enterprises.

That accounts for all the business handled by trust companies, by private trustees, and by what are known as inter vivos trusts where a man in his lifetime creates a trust.

And beyond the trustees you have in New England a great many educational institutions and a great many insurance companies of all kinds, some foundations and, of course, the usual run of charities. And it has been estimated, I believe, by the Federal Reserve bank that 45 percent of the money was tied up in that manner. How correct the estimate was, I do not know.

The CHAIRMAN. With respect to the creation of trusts by the makers of wills, do I understand you to express the opinion that more trust estates are being established than ever before?

Mr. GRISWOLD. A great many more, sir.

The CHAIRMAN. Is that because the maker of the will does not want to distribute his property to his heirs, or is it because of charitable trusts of one kind or another?

Mr. GRISWOLD. No, not charitable trusts. In the old days only the wealthy, roughly speaking, used the trust device and left their property in trust. Nowadays the small trust companies are fully equipped to do the business and the average size of trust accounts today is around $15,000 to $20,000 apiece. It is down in a very low bracket.

The CHAIRMAN. That is rather a low bracket.

What is the purpose in the mind of the maker of the trust? To prevent an heir from spending the money? Does it mean lack of judgment in the heir?

Mr. GRISWOLD. I will leave my own property in trust for two reasons, and I guess these are the reasons other people do. I would not trust my daughter to run any money I might leave her efficiently. She does not know anything about it, and neither do other people's daughters. That is one reason.

Another reason is that one inheritance tax is enough. And if you leave it outright to your daughter and she dies the next day, there is another inheritance tax when it goes to a brother or to her children. And by leaving property in trust there is only one inheritance tax, which is as it should be.

The CHAIRMAN. Now those are two understandable reasons, even though they may not be reasons that would be accepted by the rank and file of the members of the Women's Party.

Mr. GRISWOLD. Well, they are the reasons just the same.

The CHAIRMAN. Now you have the trust companies, investment companies, insurance companies, savings banks, colleges and educational institutions, and foundations. Now the latter group represents institutional acquisitions of savings of one kind or another, do they not?

Mr. GRISWOLD. Yes, sir.

The CHAIRMAN. In other words, we are establishing a sort of collective ownership of the wealth of New England. Forty-five percent is now under collective management of one kind or another. Is that not true?

Mr. GRISWOLD. Yes, sir.

The CHAIRMAN. And what about the other 55 percent? What form does that take?

Mr. GRISWOLD. Well, the remaining 55 percent is owned, let us say, half by the rich and half by the poor. I do not know the proportions. But the rich are not going to go into venture-capital enterprises because they are not saving any money any longer, they are paying taxes with it. Also they get unjustly treated, as I pointed out, under the Revenue Act if they try to get into venture-capital corporations.

When it comes to the poor, they should not go into venture capital companies, anyway. So you end up with zero.

The CHAIRMAN. I wonder how that harmonizes with the statement that you made a little bit later to the effect that these open-end investment trusts have about $1,800,000,000 now for investment in just this sort of common stock.

Mr. GRISWOLD. I did not say that, sir. I said they invest most of their money in first-class securities. All that I advocate is that they and life-insurance companies invest a small part of their assets in bringing along new enterprises.

The CHAIRMAN. Oh, yes. The figures which are before us would indicate that actually, in spite of the taxation, there is a tremendous amount of saving in the United States. And this morning we had the evidence of Mr. Du Mont that taxes did not prevent the development of the Du Mont Television Co.

Mr. GRISWOLD. I have not asked any tax relief on the companies that American Research puts money into. We can operate our affiliates under the present tax laws, although we would rather have slightly more liberal carry-overs. Generally speaking, it is all right.

The CHAIRMAN. My remark was prompted by your sentence:

> Furthermore, wealthy individuals who formerly were often disposed to use part of their savings for venture capital now find it necessary to use practically all of their savings in paying Federal income taxes, so that they are no longer so disposed to make venture capital investments.

Now, if we were to suggest to the Congress that this modification which you recommend of section 361 with respect to these venture-capital companies be made, your testimony to us is that there would be a very large increase of money from wealthy individuals available for investment in venture capital.

Mr. GRISWOLD. I think there would, sir.

The CHAIRMAN. And the Federal Government, you said, would lose nothing in taxes by reason of the modification—with which I think I agree.

Mr. GRISWOLD. Back after the first war, if you wanted, or anybody wanted to get up a new company like Du Mont or any new enterprise, it was not at all difficult for the promoters to go around and raise capital. I was instrumental in helping get up what was then a brand new enterprise company called Dewey & Almy Chemical Co., which is now a fairly large company. They practically passed the hat around among 20 people and asked for $5,000 or $10,000 apiece and got it. Try it today and you will have a difficult time.

The CHAIRMAN. Is that not, Mr. Griswold, probably because of the reason you yourself gave a little while ago, that wealthy individuals no longer have the facilities to watch the money that they put in the sort of new enterprises we are now getting?

Mr. GRISWOLD. I would say they have not got the money today. Take a man who in those days had $50,000 a year. He probably spent $25,000, and if you asked him if he would chip in five for you for your new enterprise, he would say, sure. Today, he has $50,000 and he spends $25,000, and he gives the Government the other $25,000. And he has to think twice before he lets you have $5,000. We do get some wealthy individuals in American Research. We have substantial wealthy investors . But it would be very much easier to get more.

The CHAIRMAN. I wonder, Mr. Scoll, is the next witness going to tell us something about the type of companies into which this money does go?

Mr. SCOLL. Yes, sir.

The CHAIRMAN. My questions now would lead to that.

Mr. SCOLL. Mr. Ford, the treasurer of American Research & Development Corp. will do that.

Mr. HERTER. I have one concluding question by way of tying up the question of what happened to rich people and their investments.

Is it not true when the Government is taking, say, 50 percent and he is spending the rest for living expenses, if they have any capital accumulated they are likely to keep that in blue chip rather than risk it, because they do not dare?

Mr. GRISWOLD. They want to have the $25,000 anyway.

The CHAIRMAN. I can hardly say that I would criticize them for trying to hold on to some.

Thank you very much, Mr. Griswold, we appreciate your statement.

Mr. GRISWOLD. Thank you.

(The data on State laws referred to by Mr. Griswold, are as follows:)

SUMMARY OF STATUTORY AUTHORITY OF DOMESTIC LIFE INSURANCE COMPANIES TO INVEST IN COMMON, PREFERRED, AND GUARANTEED STOCKS IN STATES WHERE PRINCIPAL INSURANCE COMPANIES ARE DOMICILED

California (secs. 1190–1199 Ins. Code 1945, as amended by Stats. 1947, Chs. 601, 172).

Any domestic insurer after investing an amount equal to its required minimum paid-in capital in statutory securities (Secs. 1170–1181) may invest in the stock of any corporation organized and carrying on business under the laws of the several States, the District of Columbia, or of the United States, provided the stock qualifies as a sound investment, is paying dividends and the price paid for the stock is not in excess of the current market value at the date of purchase. No single stock holding shall exceed in amount 25 percent of the capital and surplus of the purchaser, nor shall such purchaser hold more than 30 percent of the outstanding shares of the capital stock of any one corporation except in the case of the purchase by an admitted domestic insurer of the stock of another admitted domestic insurer.

No mention is made of guaranteed or preferred stocks as such.

Connecticut (secs, 6170, 6171, Conn. Gen. Stats, Rev. 1949)

No portion of the capital, assets, or income of any domestic life insurance company shall be used in the purchase of mining stocks; nor in the purchase of common stocks of any manufacturing company except public service companies engaged in generating and distributing gas and electricity; nor in the purchase of stock of any private corporation which during 5 years preceding purchase has not paid dividends in cash of at least 3¼ percent per annum upon the par or stated value of such stock or a stock junior thereto, the purchase of which is not prohibited by this section.

However, any domestic life-insurance company may invest its funds to the extent of not more than 5 percent of admitted assets in investments not permitted under any section of the statutes.

Illinois (ch. 73, secs. 736, 737, Smith-Hurd Annotated Statutes)

Capital surplus and other funds must be invested as provided in section 737, which inter alia permits investment in preferred or guaranteed stocks issued or guaranteed by any solvent corporation (except stocks of other insurance companies) organized under the laws of the several States, the District of Columbia, and the United States. Investment in any one company is limited to 2 percent of the admitted assets with a further limitation that no more than 10 percent of admitted assets shall be held in this class of security.

Further, a domestic company may invest in the shares of capital stock of any solvent corporation (other than a corporation engaged in banking, insurance, or real estate or a holding company of the stocks of such companies) created under the laws of the several States, the United States, and the District of Columbia, provided that the shares of such corporations are registered on a national securities exchange as such is defined in the Securities Exchange Act of 1934 and further provided that the corporation has earned in any 3 of the 5 years preceding purchase a sum applicable to dividends equal to not less than 12 percent per annum of the par value (or in case the stock is no par, of the issue value) of its outstanding shares. Such investment is limited to not more than 5 percent of the total shares of any one corporation, or more than 2 percent of its admitted assets in any one such corporation, nor shall it invest more than 50 percent of the amount by which its capital and surplus in the case of a stock company, or surplus in the case of a company other than stock, exceeds minimum capital and original surplus requirements.

Indiana (sec. 39–4202, Burns Indiana Statutes. Annotated, as amended by ch. 43, laws of 1947)

Investments of domestic life-insurance companies at the time they are made shall conform to categories and standards set forth in section 39–4202, which inter alia permits the purchase of preferred stock of or common or preferred guaranteed as to dividends by any corporation organized under the laws of the United States or any State, Territory, or possession thereof or of the Dominion of Canada or any province thereof which over a period of 7 years immediately preceding purchase earned an average amount per annum at least equal to 5 percent of the par value of its common and preferred stocks (if no par, the issue or stated value) outstanding at date of purchase or which over such period earned an average amount per annum equal to two times total annual interest charges, preferred dividends, and dividends guaranteed by it. No such investment shall be made where dividend is or has been in arrears for 90 days within the immediately preceding 5-year period.

Also permits the purchase of the common stocks of any solvent corporation organized under the laws of the United States or any State, Territory, or possession thereof or of the Dominion of Canada or any province thereof which over the 7 years immediately preceding purchase has earned an average amount per annum at least equal to 6 percent of the par value of its capital stock (if no par, the issue or stated value) outstanding on the date of purchase.

Also permitted to make investments not conforming to the preceding categories and standards of section 39–4202, but such are limited to the lessor of (*a*) 10 percent of total assets or (*b*) the aggregate of capital, surplus, and contingency reserves at end of preceding calendar year and to the succeeding paragraphs hereof.

Investments in preferred, guaranteed, and common stocks shall not exceed in the aggregate 10 percent of company's assets at end of preceding calendar year.

May not invest in the stocks, bonds, or other obligations of any corporation in which an officer of the life company is either an officer or director.

Iowa (sec. 511.8, Code 1946, as amended by laws 1949, ch. 217).

Legal reserves must be invested in the prescribed manner which include preferred and guaranteed stocks provided, however, that such stocks must meet the following requirements:

(*a*) *Preferred stocks.*—1. All of the obligations and preferred stocks of the issuing corporation, if any, prior to the preferred stock acquired must be eligible as investments under section 511.8 as of the date of acquisition; and

2. The net earnings available for fixed charges and preferred dividends of the issuing corporation shall have been, during the five fiscal years immediately preceding purchase, at least one and one-half times annual fixed charges and contingent interest, if any, and the annual preferred dividend requirements as of date of acquisition. Total holding of such stocks is limited to 2 percent of legal reserves in the securities of any one corporation and to 10 percent of legal reserves in such securities .

(*b*) *Guaranteed stocks.*—1. All of fixed-interest-bearing obligations of the guaranteeing corporation, if any, must be eligible under section 511.8 as of date of acquisition.

2. Net earnings available for fixed charges of guaranteeing corporation shall for the 5 years next preceding purchase averaged per year at least one and one-half times fixed charges to which corporation is subject as of date of purchase and shall for the year immediately preceding purchase have been not less than one and one-half times the fixed charges to which corporation is subject as of date of purchase, except that all guaranteed dividends shall be included in fixed charges.

Securities shall not be eligible if the corporation is in default on fixed obligations as of date of purchase, or as to preferred stock if issuing corporation is in arrears as to any preferred dividends, nor shall securities be eligible in excess of 10 percent of the legal reserve of company.

There is apparently no statutory limitation on the investment of funds over and above legal reserves.

Massachusetts (sec. 66, ch. 175, General Laws 1932; sec. 7, ch. 121A, General Laws 1932)

Except as otherwise provided, no investment by a domestic life insurance company may be made in stock which may be or become liable for an assessment except for taxes or investment in its own or any other insurance company stock. No investment, acquisition, or holding may be made, directly or indirectly, in more than 10 percent of the capital stock of any corporation nor shall more than 10 percent of its capital and surplus be invested in the stock of any one corporation.

Nothing shall prevent a domestic life insurance company from investing its funds exclusive of three-fourths of its reserve in any manner which its board of directors may determine except the purchase of stock prohibited in the preceding paragraph. Without the limitation imposed by the preceding paragraph, investment may be made in the capital stock of a trust company incorporated in and doing business in the Commonwealth or of a national banking association incorporated under Federal law and located in New England if such trust company or association has paid cash dividends of not less than 4 percent of its capital stock in each of the next preceding 5 years and if the amount of their surplus is at least equal to 50 percent of the amount of its capital stock; but no such life company shall invest in the aggregate an amount in excess of 2½ percent of its reserve in such stock, nor shall it invest an amount in excess of 2 percent of its reserve in the purchase of stock in any one such company or association except if merger or consolidation of one or more such companies or associations, in which case maximum of 2½ percent of such reserve may be used to acquire stock of the absolving or consolidated trust company or national banking association, if such stock is received in exchange for stock of the consolidating or merging companies or associations owned by the life company at the time of the merger or consolidation. Such a life company may also invest its funds over and above three-fourths of its reserve in the transferable certificates of participation or shares of an association or trust, as defined, provided either—

(1) That not more than 10 percent of its capital surplus may be invested in the transferable certificates of participation or shares of such association or trust which are secured by collateral; or

(2) That not more than 10 percent of its capital or surplus may be invested in an issue of not less than $50,000,000 of such certificates or shares of such association or trust which are not secured by collateral if such association or trust has net earnings for the preceding year in excess of $1,500,000 after deducting operating expenses, taxes, and depreciation charges and at least equal to twice the interest charges on such certificates or shares and if such investment has the prior approval of the commissioner as not being prejudicial to the best interest of the policyholders of such company.

Subject to approval of the commissioner of insurance, the stock of this State's urban redevelopment corporations are legal investments for the capital and other funds of insurance companies.

Missouri (sec. 6032, Revised Statutes 1939)

Capital, reserve, and surplus of all domestic life insurance companies must be invested in prescribed manner which includes preferred or guaranteed stocks of any solvent corporation organized under the laws of the United States or any State, Territory, or possession thereof, or the District of Columbia, if all of the prior obligations and prior preferred stocks, if any, of such corporation, at date of purchase, are eligible as investments under any provision of this act and if the following requirements are met.

(*a*) Preferred stocks are qualified if both—

1. The net earnings of such corporation available for its fixed charges for the next preceding 5 years shall have averaged per year no less than one and one-half times the sum of its average annual fixed charges, if any, its average annual maximum contingent interest, if any, and its average annual preferred-dividend requirements applicable to such period; and

2. During the last 2 years of such period, such net earnings shall have been no less than one and one-half times the sum of its fixed charges, contingent interest, and preferred-dividend requirements (cumulative or noncumulative, paid or unpaid) for each year.

(*b*) Guaranteed stocks are qualified if the net earnings of the assuming or guaranteeing corporation for a period of the next preceding 5 years shall have averaged not less than one and one-half times its annual fixed charges as of the date of purchase, construing fixed charges to include the amount of guaranteed dividends of such issue or the rental covering the guaranty of such dividends.

No such company shall invest in any of such securities in excess of 5 percent of its admitted assets on last annual statement preceding purchase on file, in the total amount of such stocks, and no such company shall own such stock in any one corporation, which in aggregate, represents more than 5 percent of the total of all outstanding shares of stock of that corporation.

New Jersey (secs. 17:24-1, 17:24-2, Revised Statutes, as amended, including ch. 157, laws of 1948)

Permits capital, surplus, and other funds to be invested in capital stock of any corporation of the United States or any State provided that no purchase of the stock of any class shall be made on which dividends have not been paid during each of the past 5 years preceding purchase unless stock so purchased shall represent a majority in control of all the stock then outstanding, and provided further, that in the case of the stock of a corporation resulting from or formed by merger or consolidation less than 5 years prior to such purchase, each consecutive year next preceding the effective date of such merger or consolidation during which dividends shall have been paid by any one or more of its constituent corporations on any or all classes of its or their stock in an aggregate amount sufficient to have paid dividends on that class of stock of the existing corporation whose stock is to be purchased, had such corporation then been in existence, shall be deemed a year during which dividends have been paid on such class of stock; provided, however, that nothing herein contained shall prohibit the purchase of stock of any class which is preferred, as to dividends, over any class the purchase of which is not prohibited by this section; and provided further, that no purchase of its own stock shall be made by any insurance company except for the purpose of the retirement of such stock or except as specifically permitted by any law of this State applicable by its terms only to insurance companies.

No domestic life-insurance company shall purchase more than 20 percent of the common stock or of any other class which entitles the holder thereof to vote at all elections of directors of any one corporation, unless it be a municipal corporation, or except for another insurer's capital stock, and such investment not inconsistent with other insurance company provisions and competition not lessened or monopoly created.

New York (secs. 79, 80, and 81, New York Insurance Law, including Laws 1948, ch. 578)

Permits reserve investment inter alia in preferred or guaranteed stocks of solvent companies incorporated under the laws of the several States, the United States, or any district or territory thereof. If the prior obligations of the issuing company are eligible as investments under this article and the net earnings available for fixed charges during the 5 years next preceding the date of purchase shall have averaged per year not less than one and one-half times the sum of the average annual fixed charges, its average annual maximum contingent interest, and its average annual preferred dividend applicable to such period, and during each of the last 2 years of such period net earnings have been not less than one and one-half times the sum of its fixed charges, contingent interest, and preferred dividend requirements for such year; guaranteed stock requirements are essentially similar to those of the preferred.

No life-insurance company shall invest in any preferred stock or shares of any institution in amount in excess of 10 percent of the total issued and outstanding shares of such institution, or in excess of 2 percent of the admitted assets of such company.

Acquisition of another insurer's capital stock permitted if not inconsistent with other insurance code provisions and competition not lessened or monopoly created.

May invest in stock of any housing or redevelopment company organized under any public housing or development company State law, or of any corporation organized for the purpose of owning and operating any housing project authorized under this State's real-estate housing law for life-insurance companies, whether or not located in this State, to the extent and upon conditions of superintendent of insurance; provided all the stock (other than director's qualifying shares) of such companies has been or is to be originally issued to one or more insurance companies.

May invest in capital stock of a Federal home loan bank in the amount necessary to qualify for membership therein and in such additional amounts as are approved by the superintendent of insurance.

May invest but not in excess of 25 percent of total of admitted assets in shares of a savings and loan association or savings accounts of a Federal savings and loan association insured by Federal Savings and Loan Insurance Corporation.

Ohio (secs. 9357, 9357.1, page's Ohio Code Anno)

Capital, surplus and all accumulations of every domestic life insurance company shall be invested as provided in section 9357. This section permits inter alia investment in the preferred stock of any company organized under the laws of the United States or the several States thereof engaged directly and primarily in the production and sale or in the purchase and sale, of electricity or gas or in the operation of telephone, telegraph, or water works, if the average annual net earnings of such company for a period of 5 years preceding purchase, after deduction of interest charges and charges for replacements, depreciation, and obsolescence, shall have been at least two times preferred dividend requirements, and fixed obligations and funded debt, including the preferred stock, does not exceed 70 percent of total capitalization.

Investment is also permitted in the preferred stock of any other company organized under the laws of the United States or the several States if the average annual net earnings for a period of not less than 5 years preceding purchase after deducting all interest charges and charges for replacements, depreciation, and obsolescence shall have been at least four times preferred dividend requirements and the fixed obligations and funded debt including its preferred stock does not exceed 60 percent of total capitalization and in case of appreciation in value of stocks, the cost rather than market values shall be used.

No preferred, however, shall be purchased at a time when the total market value of such stocks, then owned with those purchased, shall exceed the aggregate of book values and purchase price the capital, surplus, and contingency funds of such company (excluding all reserves required by law) as of the prior December 31.

No such company shall at any time have invested a sum exceeding 1 percent of its admitted assets as of preceding December 31 in preferred stock of any corporation nor at any time own more than 25 percent of the outstanding stocks of any corporation.

Additional investment permitted not in excess of 5 percent of its admitted assets in stock certificates of any one Ohio building and loan or Federal savings and loan association to extent same are insured by Federal Savings and Loan Insurance Corporation.

Although common or guaranteed stocks are not specifially mentioned, provision is made whereby a domestic legal reserve life-insurance company may invest its funds to an extent not exceeding 5 percent of total admitted assets in nonlegal investments.

Pennsylvania (sec. 2, Act 93, Laws 1947)

Capital and not less than three-fourths of the reserves of any domestic life-insurance company shall be invested in prescribed securities which do not include common, preferred or guaranteed stocks.

Surplus, and the balance of the reserves (one-fourth) may be invested in the stock or shares of any solvent corporation incorporated under the laws of the United States or any State, District or Territory thereof, or of the Dominion of Canada or any Province thereof, except the stock of an insurance company transacting a like class of business or stock or shares which may become liable to any assessment.

No investment shall be made in assessable stock or in any unincorporated business other than a business trust or which would result in total investments in common stock or common shares exceeding the following percentages of admitted assets:

1. Stock or shares of any one corporation, other than stock or shares in a housing or business, commercial or industrial income-producing corporation, all of whose stock or shares, except directors' qualifying shares, was at the time of acquisition owned by such insurance company or by insurance companies authorized to do business in this Commonwealth, 2 percent.

2. Common stock or common shares of corporations, excluding stock or shares in a housing or business, commercial or industrial income-producing corporation, and excluding stock or shares guaranteed by corporations whose obliga-

tions would be eligible for investment under the three-quarters legal reserve investment section.

3. Stock or shares of corporations, incorporated for a housing or business, commercial or industrial income-producing corporation, 10 percent.

Tennessee (secs. 6204, 6207, William's Code Anno)

Domestic life-insurance companies may invest their funds in dividend paying, common or preferred stock of any corporation created under the laws of the United States, or of any State, Territory, or possession including the District of Columbia, provided:

(*a*) Such stocks, except shares in a real-estate company, are approved by the commissioner of insurance and banking;

(*b*) Investments in stocks shall not exceed a total of 50 percent of the amount by which capital and surplus exceed the minimum capital and surplus requirements, except that such investments may be made to the full extent of the excess of its capital and surplus over the minimum capital and surplus requirements if such investments in excess of the aforesaid 50 percent are secured by reserves, for that specified purpose, in an amount equal to 50 percent of such excess;

(*c*) No such company shall have more than 2 percent of its admitted assets invested at any one time in stocks of any one corporation nor shall its funds be invested in more than 5 percent of the outstanding stock of any banking or insurance company, except share already held together with stock dividends thereon provided such shares together with any share hereafter required shall not exceed 5 percent of the outstanding stock of any banking or insurance company. Provision made for charging down any preferred stocks so purchased and held as may be approved by the commissioner of insurance and banking or to an asset value at which said stocks will afford a rate of dividend yield equivalent to the normal dividend yield on such stocks, and

(*d*) No stock of other insurance businesses of the same type or class may be acquired where such acquisition substantially lessens competition, restrains commerce or creates a monopoly; provided, however, such stock may be purchased solely for investment where such stock is not used by voting or otherwise to bring about or in attempting to bring about the substantial lessening of competition.

Companies may invest their funds in accumulations in stock issued under the provisions of the act of the Congress of the United States entitled "Federal Home Loan Act" and any amendments thereto.

Vermont (sec. 6968, Public Laws)

Permits investment in preferred and guaranteed stocks provided that all prior obligations, if any, are eligible for investment and net income available for fixed charges for a period of 5 years preceding purchase has averaged per year not less than 1¾ times fixed charges, contingent interest and preferred dividend requirements and that net income in each of the last 2 years of such 5-year period shall have been not less than 1¾ times fixed charges, contingent interest and preferred dividend requirements for such year.

In the case of guaranteed stocks, net earnings of the guaranteeing institution must have averaged per year in the 5-year period immediately preceding purchase, 1½ times fixed charges including the amount of guaranteed dividends and during last year of such period, such net income shall not be less than 1½ times its fixed charges including the amount of guaranteed dividends.

Total amount invested in preferred or guaranteed stocks shall not exceed 5 percent of assets, nor shall it own more than 5 percent of total issued and outstanding preferred or guaranteed stocks.

Such company may also invest not exceeding 1 percent of its assets in corporate or trust securities not otherwise authorized, provided:

1. Corporation or trust has capitalization of not less than $10,000,000.
2. Amount invested in such securities in any one company or trust not to exceed 2 percent of assets of such company or trust.
3. Earnings of such company or trust applicable to dividends in each of five preceding years shall have been not less than 4 percent.

Common and other stock investments authorized in the case of land companies, and such holding is limited to a period of 10 years without approval of commissioner.

Virginia (secs. 4168b 37, 4258a, Code 1942 as amended)

No domestic mutual life-insurance company shall invest its funds or assets exclusive of capital in excess of $100,000 and surplus in excess of $50,000 except as provided in section 4258a which inter alia permits investment in the preferred stock of any solvent institution incorporated under the laws of the United States or any State thereof, where in any one of the 3 years preceding investment, applicable earnings have been at least equal to three times preferred dividend requirements after giving effect to such new financing and further provided that the bonds, debentures, or notes if any of such institution are eligible investments under section 4258a, subsection (4), which requires that bond interest charges be earned at least twice in each of preceding 3 years and total of such obligations not in excess of 2 percent of investing company's assets.

Total investment in any one issue of such preferred stock limited to 1 percent of assets.

Investment is also permitted in stocks guaranteed by any solvent institution incorporated under the laws of the United States or any State thereof where the guaranteeing corporation has not failed to earn in any one of the 3 years next preceding investment an applicable sum equal to at least twice the amount of interest on outstanding indebtedness and guaranteed dividends. Total in any one issue of such guaranteed stock shall not exceed 1 percent of assets.

Investment in shares in any Virginia building and loan association and any Federal saving and loan association engaged in business in State may be made.

No investment in assessable stock permitted.

Wisconsin (secs. 206.34, 219.05, Wisconsin Stats. 1947)

Every life insurance company may invest its assets inter alia in the preferred stock of any solvent company organized under the laws of the several States, the United States, or the Dominion of Canada or any Province thereof (except the preferred stock of a holding company) provided either that the net earnings available for fixed charges and preferred dividend shall have averaged per year not less than two times the sum of the annual fixed charges, maximum contingent interest, and preferred dividends in the 5 years immediately preceding purchase or net earnings available for fixed charges and preferred dividends in each of the 3 years immediately preceding purchase have been 1½ times such fixed charges, maximum contingent interest, and preferred dividends.

No investment in any one company shall exceed one-half of 1 percent of admitted assets nor shall the aggregate of investments in preferred stock exceed 5 percent of admitted assets.

Further provision is made for an investment not to exceed 5 percent of admitted assets in loans, securities or investments whether or not such qualify or are permitted as legal investments. This would appear to permit investment in common and guaranteed stocks up to the limitation provided by domestic companies.

Investment in shares of any savings and loan association to extent insured or guaranteed by Government of the United States or agency thereof including Federal Savings and Loan Corporation; also in shares of corporation organized under section 5 of the Home Owners Loan Act of 1933. Another act apparently limits investment in shares of any local savings and loan association to $5,000.

EXTRATERRITORIALITY

Some States have sought to apply their statutory limitations to companies from other States as well as domestic companies. In some phases, this has been sustained in court, in others it has not been adjudicated.

For instance, a Massachusetts company doing business in New York is required to be in substantial compliance with the New York investment law. The limits of "substantial compliance" have not yet been fully defined.

The CHAIRMAN. Mr. Ford, we will be glad to hear from you.

STATEMENT OF HORACE S. FORD, TREASURER AND MEMBER OF THE EXECUTIVE COMMITTEE, AMERICAN RESEARCH & DEVELOPMENT CORP.

Mr. FORD. I am treasurer and a member of the executive committee of the American Research & Development Corp. My principal occupation is treasurer of Massachusetts Institute of Technology, which is a stockholder of American Research & Development Corp.

I am making this statement on behalf of George F. Doriot, president of American Research & Development Corp., which is hereinafter referred to as American Research.

Bearing in mind the objectives of the corporation as previously stated, the task facing American Research is to find out and demonstrate that, with the proper amount of organization, cooperation, wisdom and foresight, risk capital can be made less risky. It is obvious that it is a very difficult game, which for many years could be played successfully by individuals, at the time when chances could be taken, when taxes were low, when technical knowledge was not as important as it now is and when profits were not absorbed by taxes to as great an extent as at present.

The operating problems of American Research are:

1. To find good projects.
2. To analyze the projects received.
3. To set up the proposed organization and to negotiate with the person who brought in the project.
4. To give continuous assistance to the new company.

Stating the problem in another way, one might say that American Research is looking for three things at the same time:

1. A good idea or good product in a field of interest.
2. A good man to commercialize those ideas or products.
3. Good timing.

The cost of investigating projects is high. It requires knowledge of the present, understanding of the past, and of what goes on in the particular field, of competition problems, trends and evolutions in techniques, design, production, marketing and customer habits. It was apparent when the company was started that bringing together under one roof a staff capable of completely investigating and rendering final judgment as to many products in different fields would be much too expensive, and therefore American Research management came to the early realization that it could be successful only if it could muster not only in this country, but abroad, a group of stockholders of good will who would be interested in this challenge and who would be willing to assist in discovering projects, analyzing them, and helping in the operation of the companies formed.

American Research management hopes to convince many people of ability and experience that young men deserve to receive from older people the same kind of help that those older people had from someone earlier in life. American Research believes that its success, when it comes, will be in great part due to its ability to bring together two generations; the older one which has lived, has had many shocks and experiences which have brought judgment and wisdom, and the younger one with ideas and as yet neither knowledge nor fear as to what cannot be done, or how to go through a depression when one comes and also how to survive hard times. The general objective, therefore, is to group together able young management talent together with older wisdom, as represented by American Research's representatives on our companies' boards.

This previous point is important because we are trying to build businesses with young men who come to us with new ideas which they have never tried to carry out and along the lines of which they have had little or no experience.

When a commercial bank receives a request for a loan, its clients come in with a long history behind them. Their products, assets, organization and equipment can be evaluated, the personal history of the participants in the activities they are asking financing for can be gaged and measured, and their pasts can to some extent be extrapolated. In the case of American Research, people come claiming they can do things which they have never before done, and, in some cases, that no one has done before. In such cases there are no fixed assets to measure and no past experiences to gage and little of a yardstick available. Everything must be a matter of judgment—judgment of men and judgment of products not previously manufactured.

The procedure is as follows: First the management of American Research does not merely sit and wait for projects to come. The company goes out of its way to make its existence known to individuals, to bankers, to research laboratories, and so forth. Particular efforts have been made to convince large manufacturers that in many cases they are obtaining byproducts of their research effort which do not fit in their normal line of products or are in too small a demand for them to handle. Both of these possibilities should not be stored and frozen by such companies but should be made available to American Research, because those products could be the basis of a new venture. Large companies also frequently develop instruments for their own use, and those instruments could often be the basis of a new venture. The attempts to interest large companies have not often been succesful, probably because of American Research's lack of time.

Mr. Herter. I wonder if I might interrupt at this point, Mr. Ford. Skimming rapidly over your written testimony, I notice that you mentioned only one of the companies that American Research & Development Corp. is engaged in. I think it would be very helpful, I know it would to me, if we had some idea of the types of things these various companies you are financing are now doing.

Mr. Ford. Would you like to have me introduce that now or at the end of my testimony?

Mr. Herter. I think perhaps now, and during the rest of your testimony we would have to apply as a background.

Mr. Ford. I will brief, if you do not mind, the general type of investment.

When the money comes in, and you have nothing, it goes into Government short-terms, or in our case at present a small amount of commercial paper. And then you make your first commitment.

I think these are arranged in alphabetical order.

The first one that appeared was the Baird Associates of Cambridge, Mass., in which they manufactured spectrochemical instruments for industrial control purposes.

One of their instruments is such that instead of waiting for the chemist to determine the content of a mixture of metals, such as is involved in most industries, one of these recording spectrometers analyzes within 1 percent the weight of the different elements in that in a very few minutes. It saves days of operation.

Baird Associates is the associate of one of the old companies in a new field. This is one of the companies which was in existence in a small way and desired to spread its products.

When we came in to it, they stepped up the number of items. They have a gas analyzer which will analyze a gas flowing continuously and give recordings of it. In other words, it is an automatic controlling device generally useful in large companies.

Mr. SCOLL. In this particular case your participation was to give them working capital with which to enlarge their field of operation?

Mr. FORD. That is correct.

The second one is Berry Motors, and here is an exactly similar case.

The utilization of high-pressure hydraulics for the control and transmission of power gained great impetus during the war when such systems saw increasing use as actuating mechanisms on aircraft, tanks, and ships.

These applications intensified the need for efficient, versatile, and inexpensive, high-pressure pumps and motors for driving vehicles, machinery, and a wide variety of equipment accessories.

The Berry pumps, motors, and compressors are of an ingenious positive-displacement type using a rotary piston interacting with a rotary abutment valve once during each revolution.

This is a little bit technical and I will not go into it except to say that the standard Berry pumps operate with very high efficiency at pressures ranging from 500 to over 3,000 pounds per square inch. So you see they are quite beyond the ordinary possibilities of the usual pump-manufacturing outfit.

Mr. SCOLL. And this, again, was additional capital to spread into a new field?

Mr. FORD. That is right. And this company has not yet appeared in our picture as a really operating company. Contracts have been made with some large manufacturers, and it is expected they will really show next year. You have to wait on some of these before they appear.

The next one I am personally familiar with—Circo Products Co. of Cleveland, Ohio.

That, again, was a very small and successful business making degreasing tanks, which are vaporized by a heating unit in the base. The solvent vapor condenses on the metal greasy parts that are lowered into the tank and the grease drains off into the tank itself.

Instead of spending hours, you simply pick your dip and take it up. That is true for automobiles and otherwise.

Now products which prompted the investment in this company, or the product, is a small cleaner which is used for removing dirt and old grease from the differentials and transmissions of automobiles and trucks. It is known as the DEE-TEE cleaner and solvent.

It is a very small device that can be attached, and then by pressure and heat the entire inside of your crankcase and differential and transmission is absolutely cleaned. And if you have had experience with the garage men, you know how long that takes.

Now the reason for financing this company was to enable them to make a departure from their original line and take on another line, and that has been done.

The next one is the most unusual in some ways of our commitments, and that is the Cleveland Pneumatic Tool Co. of Cleveland, Ohio, which is the largest company manufacturing aircraft landing gear equipment in the United States.

That company is supporting a development program carried on at the Arthur D. Little Co., of Cambridge, Mass., which shows promise of long-range significance in fields other than commercial and military aviation.

I cannot disclose them, frankly, because I do not know them and nobody knows at the present time. It is purely venture.

The reason for our appearing in it is because the Cleveland Pneumatic Tool Co., which, as I said, is the largest manufacturer of aircraft landing gear. They have about five items.

Although some day they may not be in the same happy position, their president tells me they have such a large backlog of orders they are not doing much else.

We supplied capital to them to make an effort to diversify products, which, if it came out, would benefit us by giving us participation in the final end product. It is a very unusual procedure and has not been duplicated.

I think the next one, perhaps, would be more understandable, and that is the investment in the Colter Corp., Palacios, Tex.

The Colter Corp. was formerly set up by the Kroger Co.

The Kroger Co. used it as a manufacturing source for shrimp, or the processing of shrimp.

Now the reason the company invested in that was, one, to get a product which could be diversified greatly. There are plans for diversifying not merely in the shrimp business but the introduction, rather, the processing of all kinds of fish and shellfish.

There is another reason, too. It was a going concern, and a company like American Research has to have one or two things that are not 3 months, 6 months, 2 years away in the offing. You have to have a little knitting, as it were, to go on.

Colter has a business. Our plan is to increase that business to the point where modern food technology will step in and utilize all the waste and pick up additional products from which the plant is able to operate. I mean it is set up to operate twice the capacity needed for the shrimp that are brought in.

Another company is the Exmet Electrical Corp. That is a new patented type of resistance element. And by the way, this came from development work in England. I refer to that in the paper later on.

We have interesting connections there. And this resulted in a new patented type of resistance element produced by expanding sheets of special metals into open wire mesh of carefully controlled characteristics.

That is not a very good description, but the company's products offer unusual competitive advantages in the electrical field as high-power resistance elements for the dissipation of heat. It is very much in the progress stage rather than in the completed stage.

Mr. HERTER. That is entirely a new company formed for such purpose?

Mr. FORD. Yes.

This is an interesting one—the Flexible Tubing Corp. of Branford, Conn.

This is a very small company, and it came out of the work being done by the Warner Co. of Bridgeport in connection with war work in manufacturing flexible tubing, made of a fabric covering combined with a spiral wire reinforcement.

I think you see it on an airfield when the truck comes up to inject hot air into the otherwise cold plane. You find a very large spiral wire tubing with a fabric covering, and it is used in connection with sucking out the complete contents of carbon black.

It is also going to be used in connection with another company I will speak of in a minute, and that is the conduct of very highly heated hot air for heating purposes.

And this company is down in Branford, Conn., and it is a good illustration of exactly the sort of thing that would not flourish probably unless some company like American Research stepped into it.

Now it comes to a very interesting one with which I am quite familiar—the High Voltage Engineering Corp. of Cambridge, Mass.

This is one of the first commitments we made. It is engaged in the manufacture and sale of 2,000,000-volt, constant potential Van de Graaff generators.

These generators are used in radiation therapy for deep cancer tumors. And it is the sort of a project that no one in the world except a company set up as American Research would even think of looking at, because it takes 8 to 10 months to make one of these generators. They sell for about 30 to 40 thousand dollars. And it just would not be expected, as I say, except of a company with the technical background and advisers and staff of the American Research. Any individual investor would never have looked at this twice. Yet it is one of the high spots of our investment because it takes 3 years to bring this to a jell, if I might use that expression. But this year they have done very well, and they have a backlog of orders which is quite surprising when undertaking to sell a $40,000 item.

The CHAIRMAN. May I interrupt you at this point, Mr. Ford?

When I asked Mr. Griswold to come to the table, it was to show him some figures which are published in our little monograph entitled "Factors Affecting Volume and Stability of Private Investment."

On page 156 of this document we have a table entitled, "Individual Taxpayers, Rate of Taxable Return Equivalent to Selected Rates of Tax-Exempt Income, by Income-Tax Classes." This is compiled on the rates as provided in the Revenue Act of 1948. Much of this material was developed during the hearings on the revenue bill of the Eightieth Congress. But in any event I will put the whole table in the record at the conclusion of your testimony.

It shows that some 52,600,470 tax returns were filed with the Bureau of Internal Revenue, reporting adjusted gross income of $134,300,000,000.

The returns are divided according to class in the thousands of dollars, beginning with $1,500, $1,800, $2,000, $2,500, $3,000, $4,000 and so on.

I have just made a rough addition here, and I find that of the $134,300,000,000 reported by all of the income taxpayers, including everybody over a million dollars, the aggregate income reported by those who had $10,000 a year and under amounted to $115,000,000,000 out of the total of $134,300,000,000, thereby indicating that the great reservoir of capital which is to be tapped is not the savings of the wealthy any more, it is the savings of the masses of the people in the lower income brackets.

I was very much impressed several years ago in going into this general subject to find that when the Treasury Department financed World War I, and for the first time in history issued securities in small amounts—the 100-dollar bond, the 50-dollar bond, the 25-dollar bond, and savings stamps—they tapped a wholly unsuspected source of capital.

Following that the stock exchange took the hint. Prior to World War I the New York Stock Exchange never dealt in securities in less than 100-share lots. The odd-lot technique was developed after that. And many, many millions of dollars were brought into the investment market through the sale of small amounts of stock to small people, but a lot of them got burned in the speculation that preceded 1929.

Sometimes I think that it may be that experience which is the principal deterrent now to the investment of money in equity capital. But I would not pretend to say that is the fact.

But it seems to me clear that you gentlemen with your research corporation and your effort to create corporations to provide opportunity for investment capital are opening the avenue through which we tap for investment this reservoir of the savings of the small people of America. Our obligation is to devise rules and regulations and standards of responsibility as to make sure that funds can be safely invested, or, to use the phrase with which you began your paper, Mr. Ford, "make risk a little less risky," or to make risk capital a little bit more secure.

Mr. Ford. May I say a word there, Senator?

The Chairman. Surely.

Mr. Ford. This great amount in the hands of the small investors, at the time we started our corporation, we deliberately bypassed because we did not want at the beginning to have people of small means invest in a company with an idea that there might be a return for the first 6 months, or for the first 12 months, or for the first 36 months. So, we limited the individual subscription to $5,000, which took the little man out of it.

It was perfectly well understood we did not expect this would produce an income promptly. I think that is going to be quite a hurdle to overocome unless you do it through some such method.

It seems to me you could not expect the small investor to take five shares of American Research very well if he were wondering whether he would get any income on it of any sort for many years.

The Chairman. I rather imagine there are a lot of small people who are really willing to venture into the field of venture capital provided they knew where a reasonable venture might be found. Such a corporation as this is engaged in the business of selling good judgment and research ability. That is the name of the corporation, the American Research & Development Co. So that I do think you might possibly, indeed, find savings that would welcome the opportunity. However, that is just an expression of opinion.

Mr. Ford. I think one good operating sheet would help a great deal. We have tried this last year to sell an adidtional amount of stock and we did not succeed in interesting the small investor.

Shall I continue with these or go into the paper?

The Chairman. I think you might summarize those for the record if you will, Mr. Ford.

Mr. Scoll. How many companies are you in altogether?

Mr. Ford. There are 13 companies and there were 3 approved at the last directors' meeting.

Mr. SCOLL. So, you have 16?

Mr. FORD. Well, 16 beginning with the first of the year.

Mr. SCOLL. Are all of them the sort you have indicated, in the field of new products and instrumentation except the shrimp business?

Mr. FORD. No; there is one other even more fantastic than the shrimp business, and that is the Island Packers, Inc., fishing for tuna in the Fiji Islands, having them canned in Samoa and bringing them to the Pacific coast and competing with the Pacific coast packers. It is a joint project in which we are participating with some others.

Mr. SCOLL. Is that the one Westinghouse is in?

Mr. FORD. No.

The CHAIRMAN. I thought earlier in the afternoon perhaps this should have been named the New England Research & Development Co., but I see now that you are really branching out.

Mr. SCOLL. May I ask this question, Mr. Ford?

Mr. FORD. Yes.

Mr. SCOLL. This is the total number of projects that you have invested in since you began operation?

Mr. FORD. That is right.

Mr. SCOLL. And how long has the company been in operation?

Mr. FORD. Since June 1946.

Mr. SCOLL. During the period from June 1946 down to the present, how many projects have you considered?

Mr. FORD. I asked that question in anticipation, and the best answer I am able to give you is that all applications of an idea or applications of every description, there have been 3,000 come in. Fifteen hundred of them have found their ways into our project numbers. In other words, we have project numbers up to 1,500. And that represents another 1,500 that were just too fantastic to even start with.

Now, the 1,500 does not mean they have been followed through to the end. A project goes to a certain point. Some die quickly, some find a snag at this point, and some when marketing surveys come in.

Actually, we have 1,500 on the project books and 16 on the books.

Mr. SCOLL. Is it an indiscreet question to ask how many of the corporations you have gone into that you have abandoned?

Mr. FORD. None.

Mr. SCOLL. That have turned out to be flops?

Mr. FORD. None.

Mr. SCOLL. So that there is hope for all of them you are in now?

Mr. FORD. Yes.

Mr. SCOLL. Is that document you are referring to one that has been published?

Mr. FORD. It happens to be a prospectus of the company. I use it for convenience. It is the prospectus of the common-stock offering of the company last year.

Mr. SCOLL. Could we have for the record the list and description of the companies involved that you are testifying to?

Mr. FORD. I can give you the copy and also our brochure with a summary of it.

The CHAIRMAN. Suppose you do that, Mr. Ford.

Mr. FORD. Shall I proceed with the list or go back to the paper?

The CHAIRMAN. Suppose we go back to the paper.

Mr. SCOLL. What we wanted to get was the names of the companies and the products or services which they sell.

Mr. FORD. It is pretty well defined right in here.

The CHAIRMAN. The ones you have not already given will be inserted at the end of your testimony.

Mr. SCOLL. There is another question, Mr. Ford, which is: In your experience, since you have been in operation, have you found that there have been other problems or questions than just purely the matter of finance in some of these projects?

Mr. FORD. Oh, yes.

Mr. SCOLL. In other words, have you had to supply or assist in the supplying of management?

Mr. FORD. In investigating a project we work first with the product, and then with the personnel, which is the most important, the people we are going to deal with, because I might inject here, the operation of American Research does not consist in buying out some idea and waving the inventor a pleasant good-bye. In every case we go along with the people who bring in these projects and who are, themselves, desirous of setting up companies. And under those conditions we have to go through and find out markets, production, facilities of raw materials, and then we set up a summary of favorable factors and unfavorable factors.

Mr. SCOLL. Do you actually do market surveys yourself on each of these projects?

Mr. FORD. Not personally, but we have people who do; yes.

Mr. SCOLL. And have you had occasion to directly or indirectly assist these projects in obtaining necessary personnel, or do they come to you with all their personnel and everything in a package?

Mr. FORD. We are doing that exact thing this minute with two companies—possible change of personnel or addition of personnel.

Mr. SCOLL. In other words, the idea is good and the market is good, but the personnel needs strengthening, so you set about the problem of strengthening the personnel?

Mr. FORD. I think I have something in my paper that will relate to that.

The CHAIRMAN. May I ask this question? Of all of these companies in which you have now made an investment, how many had tried before coming to your company to finance their operations without success?

Mr. FORD. I doubt if I could answer that offhand. I would have to make an actual check of the records. I would guess not half went in anywhere else before they came to us.

Mr. SCOLL. How many?

Mr. FORD. Not half. What is your opinion, Mr. Griswold?

Mr. GRISWOLD. I would say half had.

Mr. FORD. That is my thinking, but I have no record.

The CHAIRMAN. In other words, approximately half of those had failed to get capital from any other source, and the other half were new enterprises that——

Mr. FORD. That came up for the first time.

The CHAIRMAN. And came for the first time because you sought them?

Mr. FORD. That is pretty nearly right. They knew we were in formation. And two of them actually held off in formation at all before they made any motion. The High Voltage is a good example.

They knew we were in the process of formation and waited 6 months before seeking any financing.

The CHAIRMAN. You may proceed with your statement.

Mr. FORD. American Research also makes a constant study of difficult or expensive manufacturing processes—processes which are costly in terms of man-hours or raw material or work in process, factory space, time, et cetera. With an understanding of the problems involved in those processes, American Research tries to think of research activities now being handled which might be used toward the solution of those costly or inefficient manufacturing problems.

Another place where American Research is very much interested is to obtain projects from abroad. The war has brought forth in this country the general feeling that only the United States is strong, wealthy, or well-equipped enough to do research; but, in spite of all the talk on this subject, it is still a definite fact that, while research is helped by good equipment, et cetera, research comes out of men's minds and not out of equipment. It should also be realized that Europeans have a large store of brain power which must be tapped. Either the results of European research will come to the United States or it will go to some other less desirable recipient. The company has therefore made an effort to interest European scientists to send to American Research the results of their work.

The second problem is the investigation of projects; and, to do so, American Research for technical advice relies considerably on its board of technical advisers, consisting of Dr. Karl Compton, Prof. Edwin R. Gilliland, and Prof. Jerome Hunsaker. Those gentlemen have worked hard and efficiently. Whenever necessary, they designate someone else to supplement their knowledge when the problem is away from their line of specialization. For additional technical help, but particularly for business advice and guidance, American Research management relies on its board of directors, made up of men of well-known standing and ability in the world of business and finance. Some of them within their own lifetimes have started the companies they now head.

At this point we can make the very strong statement that, for all the assistance, technical and business knowledge, advice and guidance that it needs, American Research goes to all of its stockholders. While our relationship with our stockholders is obviously a legal one, in our own minds we consider them as partners of this business in the most inclusive sense of the word.

The next problem is for the management to prepare a report on the company and discuss it with the executive committee. If the executive committee approves the project and decides that it should be carried on further, and also after it has pointed out additional avenues of investigation, the management then sits down with the client and tries to build up on paper at least what the new company should look like, at the same time charting as well as it can be done the operations of the company for the next 18 months. While this operation might seem hypothetical, it at least gives American Research's management a chance to study the minds of the proposed management of the new company. It gives it a chance to sense and appreciate those people's attitudes toward operating matters. The end product is what is called an operational sheet which points out the goals and problems and actions required, bearing in mind time, risk, and expense.

Therefore, the project is submitted to the board of directors and is thoroughly studied by them. Usually many of the directors know much about it, since they have been consulted during the investigation. If approved, the projects are then referred to counsel and to the executive committee for final approval.

At that time the part of American Research should be ended, but in most cases it is just beginning. In the study of new ideas and in the building up of young companies, hopes have a habit of vanishing. Everything seems to cost twice as much and take three times as long. American Research would like to have done its job of product evaluation and selection of management so well that it should not be called upon for help. American Research is frequently called on for help, and is delighted to give it when necessary. It has been the practice to have at least two members of American Research on the board of new companies. The main responsibility of those gentlemen is to be ready to help and study the particular weakness of the management so that eventually proper directors can be finally selected and persuaded to serve on those boards. If it is discovered in the first few months of operation that a particular company is weak in financial matters, then the directors selected will be men well versed in those problems. American Research is glad to say that men of outstanding ability who are sought after as board members of leading American corporations are willing and happy to give time to new ventures. It is only with such help that success will be obtained.

A leading American company before the war used to have a poster in their office stating that "from test tube to tank car takes 5 years." If it takes 5 years for a well-established, wealthy corporation to go from test tube to tank car, it is evident that it will take at least that long before a young company with little financial resources may be expected to achieve success.

The work takes much patience, tact, and courage; but, as stated above, with the help of many, it probably can be done.

It is interesting to note that most companies that American Research is in have at one time or another appeared as if they might not survive. Some of the ones doing best at the present time have already gone through the worst crises of any. It is also interesting to notice that, as usual, the weak ones are not due to misapprehensions or wrong thinking on products or technical matters, but on evaluation of men.

American Research has endeavored to help its affiliates to broaden themselves not only nationally but internationally. One of the companies, Tracerlab—I did not speak of it, but it is one of the most important and interesting we have—now owns a one-third interest in a European corporation. That interest was obtained without any dollars, but purely through an exchange of technical knowledge. It is worth while noting that Tracerlab has already received from abroad some promising patent applications.

Another of American Research's affiliates, Ionics, which at the present time probably is the most outstanding group of research talent in the formulation of new ideas on ion exchange, has already been asked to help in the formation of a western European affiliated company. It is expected that very shortly will be formed in western Europe a company corresponding to American Research itself, in which American Research, instead of its affiliates, will have a direct interest. Through that medium we expect to channel European developments in this country and, in the other direction, help with American ideas, knowledge, and business experience.

Additional developments along that line which might be of interest are, first, the fact that a group of individuals are developing in Brazil a company which is supposed to have similar aims to those of American Research and in which company American Research has been offered participation.

England, realizing the need for such a company for obvious and well-known reasons, naturally falls back on its Government for the creation of a counterpart of American Research, financed with between four- and five-million pounds of public funds.

When the company was organized, it was claimed by some people that, if only 1 or 2 out of 10 projects became successful, the American Research & Development Corp. would do well. The record to date is ahead of this average. With the continued support of stockholders, directors, advisers, friends, and the Government, the management looks forward to the future with confidence.

The CHAIRMAN. What additional information do you have with respect to the British company to which you referred to just a moment ago?

Mr. FORD. I haven't that at my beck and call, Mr. Chairman.

The CHAIRMAN. Would you be good enough to supply that information?

Mr. FORD. Yes.

(The information requested is given at the conclusion of these hearings.)

Mr. SCOLL. May I ask one question before he leaves the stand?

The CHAIRMAN. Yes.

Mr. SCOLL. Mr. Griswold has outlined where the company raised most of its funds. Have you gone to banks, or have you had any participation of interest expressed in American Research by any of the banks?

Mr. FORD. No.

Mr. GRISWOLD. Investment bankers, you mean?

Mr. FORD. He said "banks."

Mr. SCOLL. How about investment bankers?

Mr. FORD. Some participation, very little though.

Mr. SCOLL. Very little by the investment bankers?

Mr. FORD. I do not know of any bankers that have bought stocks. The interest of the bankers has been in the idea generally, because they, too, have felt that they ought to have some participation in developing research facilities for venture capital.

Mr. SCOLL. Do they refer projects to you?

Mr. FORD. Yes, very definitely.

Mr. SCOLL. What about the investment bankers?

Mr. FORD. I was really speaking of investment bankers. I know of no project, except one, that has come from straight banking.

Mr. SCOLL. I mean a commercial bank.

Mr. FORD. A commercial bank—I know of just one.

Mr. SCOLL. Only one?

Mr. FORD. Only one that we have gone into that has been referred to us by a commercial banker.

Mr. GRISWOLD. When we raised the capital for this company, we got many of the institutions to go along ourselves, but when it came to selling the stock to the rest of the public we enlisted the aid of Esterbrook & Co. in Boston, and Harriman Ripley & Co. in New York, who, I suppose, obtained about half of the capital subscriptions.

There was not much money in it for them in the form of underwriting fees, but they were very interested to see if they could not do something to help along the general cause, and they were quite constructive on the matter.

Later the firm of Clark, Dodge & Co. in New York was of considerable assistance to us in getting certain subscriptions to stocks of the company.

And one other firm, Lee Higginson & Co., participated in subsequent financing of Tracerlab, which is now our largest company. We put up the initial money together with Lessing Rosenwald Foundation, as I recall it, and then they needed some more money and we put up some more money. By that time the company looked as if it was really going places.

This is a company which exploits the commercial use of radioactive materials from the Manhattan project.

And at that point Lee Higginson stepped in and underwrote a substantial issue of, I think, a million and a quarter, or something like that.

To that extent investment bankers have entered into this picture.

Mr. HERTER. I have just one question.

The chairman has shown a great interest in the British company which is Government-financed, and that raises the whole question as to whether or not the needs in this country are such for venture capital that this committee ought to be giving any consideration to having the Government do this.

Is it your impression if the tax laws could be adjusted as you have suggested you would find sufficient number of this type of companies springing up in this country to adequately finance and take care of what you might call legitimate needs in the field?

Mr. GRISWOLD. About 3 years ago the British Government by act of Parliament created a company somewhat similar to this and voted to contribute four or five million pounds.

We are very anxious to find out how they are coming along, and very shortly a man named Lord Halsbury of England is coming over here, and we are going to find out. But I cannot tell you actually how they are getting along.

As far as our wishing Government financing in this country is concerned, I do not myself think we have yet reached that point. I think we are just on the verge of being able to raise this kind of capital from private sources.

A number of companies in this country, whose names I would rather not disclose at this point, already are seriously entertaining the proposition of providing substantial sums for purposes of venture capital.

The CHAIRMAN. That was one of the reasons why I inquired of you when you were on the stand, Mr. Griswold, about any suggestions you might wish to make with respect to modification of the law. My understanding was that you believe the Federal law with respect to these venture companies is adequate except for that change in the Revenue Code?

Mr. GRISWOLD. That is correct. The State laws are not adequate, however—certain States.

The CHAIRMAN. Would you mind preparing a statement for us with respect to your findings regarding State laws?

Mr. GRISWOLD. I have submitted an extract of the life-insurance laws of every State.

The CHAIRMAN. That is right.

Mr. GRISWOLD. As far as investment companies are concerned, the law is now adequate. The law is adequate in my opinion as far as foundations and educational institutions are concerned already.

The CHAIRMAN. And how about corporations of this type of the American Research & Development Corp.?

Mr. GRISWOLD. There is one other company that I know of in this country which engages in this sort of thing, but with this difference: They buy out the inventor lock, stock, and barrel, and take over his invention and finance it.

Our policy is the opposite of that. We provide the present owners of the business with additional capital. I presume there are other companies like American Research who are probably smaller ones. And I do not know who they are.

There are several private groups of capitalists who are doing this thing not in the corporate form. For example, the Rockefellers are carrying on much the same activities privately without the intervention of a corporation. One reason why they do it privately, I suppose, is the tax law. By doing it privately you can take your losses in your operating expenses, and if you make any gains, pay capital gains tax on it, which you cannot do in corporate form.

Also the Whitney family have a similar set-up, as I understand it, to the Rockefellers.

Mr. SCOLL. You are referring to the limited partnership set-up?

Mr. GRISWOLD. I think so; yes.

The CHAIRMAN. Any other questions, Congressman Herter?

Mr. HERTER. No.

The CHAIRMAN. Mr. Scoll?

Mr. SCOLL. No questions.

The CHAIRMAN. Dr. Kreps?

Mr. KREPS. No; except following up your own computations in this table, it is interesting that all the persons who get over $50,000 a year taxable income receive an aggregate of only $4,000,000,000.

The CHAIRMAN. Out of the 134 billion?

Mr. KREPS. Out of the 134 billion. And of course that fund should be compared with the total gross private domestic investment in 1948 of $45,000,000,000.

Mr. HERTER. An aggregate of $4,000,000,000 before taxes.

Mr. KREPS. That is right, before taxes, but adjusted for the exemptions that they have.

The CHAIRMAN. It was remarked by one of our witnesses the other day—I think it was Mr. Bryan—that the insurance industry today must find investments for $50,000,000 a day, which is a rather substantial amount of money to be invested every day throughout the year.

That impressed me with the necessity of an expanding economy, and if we are going to have an expanding economy which is a private economy—that is to say, which continues under the system of private property—we have got to find the way, it seems to me, to utilize the savings of the millions in the lower-income tax brackets, and we have got to find new objects for investment such as you gentlemen are endeavoring to find through this company.

Mr. KREPS. It is only fair to add that for those lower-income tax brackets the 80-percent figure is, of course, not applicable. You get more nearly down to 16 percent when you get to the $10,000 bracket.

The CHAIRMAN. Yes.

Do you care to add anything more, Mr. Ford?

Mr. FORD. I am only going to add that there is one more aggregation of capital coming into the picture which so far has been regarded as more or less sacred as far as venture capital is concerned, and that is the pension funds. I have been startled recently to find out how those are working up. And, if it turns out to be the case in all of the pension plans of the companies considering it, it is going to be a tremendous additional aggregation of capital now generally not looked upon with any idea of spending a cent of it except in anything but the very safest securities in the world.

The CHAIRMAN. The bluest of the blue chips?

Mr. FORD. The bluest of the blue chips and Government bonds.

The CHAIRMAN. We are very, very much indebted to you, Mr. Ford, and again to you, Mr. Griswold, for this testimony. Thank you for having given us the time in preparation and for the presentation of these two very interesting papers.

Mr. FORD. Thank you for your consideration.

(The other companies invested in by American Research and Development Corp. are as follows:)

IONICS, INC., CAMBRIDGE, MASS. (DECEMBER 1948)

Although specialized from a scientific and engineering viewpoint, ion-exchange is a fundamental chemical tool for a broad variety of applications in production and in research. Ion-exchange is already useful in such divers processes as water purification, sugar production, milk stabilization, and production of pharmaceuticals. Recent improvements have been made in developing commercial synthetic exchange resins, which make possible more widespread applications of ion-exchange. Operating costs for known processes such as demineralization of water have been reduced, and ion-exchange now affords an attractive solution to many problems which heretofore have been solved only through established complex and tedious separation methods.

Ionics, Inc., was formed in December 1948 to do consulting, research, and development work on behalf of commercial companies and Government agencies and to continue the development of a number of specific processes which will be licensed or used commercially. The company owns important process rights and patent applications and is assembling a technical staff of proven ability in this important field.

JET-HEET, INC., ENGLEWOOD, N. J. (APRIL 1947)

As the name implies, this company is engaged in the commercial development of heating units which embody the combustion principles developed for jet propulsion during World War II.

A warm-air furnace, designed for the average-sized home, provides in a highly efficient unit the competitive advantages of extremely small size, low initial cost, flexibility of installation, and interchangeability between oil and gas as a fuel. It departs radically from conventional heating methods in supplying small quantities of hot air to the rooms of a house in an insulated flexible duct. No return ducts are needed.

In addition to the household heating unit, the same basic principles hold promise of a variety of applications in industrial heating and crop drying.

Jet-Heet, Inc., is behind its original schedule because of unanticipated engineering problems. Satisfactory solutions appear to have been reached, however, and test units are now performing in accordance with rigid specifications.

The manufacture and sale of these heating units will probably be handled on a license basis under patents and patent applications held by the company. The principal existing patent of Jet-Heet, Inc., expires in 1966. Negotiations for such manufacture and sale on a license basis are currently under way with an outstanding company having an international distribution organization.

The business of manufacturing and selling these heating units will, it is believed, always be in a highly competitive field. As to the future competitive position of Jet-Heet heating units as a result of technical research and work on the part of Jet-Heet Inc., or as a result of future work and research of competitors, the company is unable to make any prediction at this time.

SNYDER CHEMICAL CO., BETHEL, CONN. (JULY 1947)

This company was formed in May 1946 to commercialize the unusual characteristics of a new type phenolic resin which combines a faster reaction cycle with higher strength. Patent applications relating to the foregoing are held by the company. The company's product is used as an adhesive in the production of plywood, furniture, and station wagons, and as a beater addition to fibrous pulps.

At the time American Research and Development Corp. made its investment, it was planned to concentrate on the sale of plywood adhesives. Many technical problems involved in adapting the company's products to requirements of individual customers have retarded the development of large volume sales. While some operational losses have resulted, the products have demonstrated superior characteristics in specific cases.

The future of this business will depend on the successful promotion of specialty uses of Snyder resins and on the further development of volume sales in adhesive and beater applications in competition with a diversity of products of other companies.

TRACERLAB, INC., BOSTON, MASS. (DECEMBER 1946)

The present operations of Tracerlab can be classified under the following general headings:

1. Development and manufacture of specialized electronic, mechanical, and chemical equipment, required for setting up a laboratory for radioactivity. Included are the Autoscaler and "64" scaler for precise radioactivity measurements; Geiger-Mueller tubes for detecting and amplifying radiations; the automatic sample changer and the Tracergraph printing interval timer, which when used in conjunction with the Autoscaler automatically measure and record the results obtained for a number of radioactive samples; the laboratory monitor and the portable radiation survey meter, which detect the presence and indicate the level of radioactivity and are primarily used for health purposes; and, demonstration units for colleges and schools. Customers include hospitals, educational institutions, private research foundations, industrial research laboratories, and Government research laboratories, including those under jurisdiction of the Atomic Energy Commission.

2. Processing and synthesis facilities for converting radioactive isotopes produced under the Atomic Energy Commission at Oak Ridge into more usable forms of research laboratories. At present, approximately 20 compounds tagged with radioactivity are available from stock.

3. Consultation and carrying out research contracts on problems involving all phases of radioactivity. Customers in this category are primarily industrial organizations and Government agencies.

4. Design and manufacture of specalized instrumentation using radioactivity for industrial measurement problems. Up to the present the major effort in this direction has been the development of gages for measuring thickness of sheet materials such as paper, plastics, and thin sheet steel.

Statement by J. H. Whitney & Co., Submitted at the Request of the Joint Committee on the Economic Report

The partnership of J. H. Whitney & Co. was established in February 1946 as a venture capital investment firm. A primary consideration leading to the formation of the firm was the belief on the part of its founders that there existed in this country a most serious need for organized sources of venture or risk capital. The traditional American system of free enterprise is dependent upon the existence of an economy in which small business can succeed and new business can emerge. An adequate flow of venture capital is essential to the continuance of such an economy. Yet, if the trend of the years since the beginning of the great depression were to continue, that flow is by no means assured.

Sources and availability of venture capital.—At the time of the formation of our firm there was not, so far as we are aware, any established financial institution set up for the primary purpose of providing venture capital to new or expanding small businesses. Commercial banks, insurance companies, investment trusts, and institutional investors are restricted not only by legal limitations but also by the restraints which as a matter of sound business practice must be applied to the investment of reserves to protect the funds of the type for which they are responsible. In general terms, they are circumscribed by the limitations which apply to the investment of "other people's money." The investment banker is primarily an underwriter of securities to be sold publicly. His capital must be kept liquid in order to meet the demands of the underwriting business, and he is therefore generally unable to make long-term investments in risk capital situations. Moreover, the public sale through investment bankers of the securities of true risk capital ventures is in most instances not feasible because the risk is too great to be suitable for the usual small investor. Also the requirements of the Securities Act, designed primarily to protect the public from poor quality investments, have had the incidental effect of limiting the raising of venture capital through investment banking channels even for ventures which are sound as risk capital investments but which by definition involve substantial risk.

Traditionally the most important source of venture capital has been the individual of more than average means. However, with the increasing rate of personal income taxes, there is little surplus available today out of current income after taxes for risk capital investment. Any small surplus available is more likely to be used in an effort to achieve a measure of personal security. This means the purchase of insurance, bonds, preferred stocks or more mature equities, with little left in any year or period of years for venture capital investments. There is still some flow of venture capital from individuals possessing large fortunes as a result of past accumulations. However, due to tax as well as other considerations, only a comparatively small fraction of such private fortunes as exist today are reaching the channels of venture capital. Moreover, with the exception of a few firms such as our own, private venture capital activities are for the most part conducted on an individualized basis so that it cannot be said that the public generally has access to this source of venture capital financing.

Most of the capital going into new developments today comes from the retained earnings of the large corporations. The new developments thus financed are an essential elements in the progress of the Nation. However, this course leads to greater concentration of wealth and economic activity. It is our belief that the economic welfare of the country is served if there is also available venture capital for the independent financing of small businesses and new developments originating outside the larger corporations.

Venture capital organizations and investment policies.—In addition to J. H. Whitney & Co., several firms have been established since the war for the making of venture capital investments. William A. M. Burden & Co., Payson & Trask, Rockefeller Bros., Inc., and Henry Sears & Co. are among those which are set up along with the same general lines as our firm. One of the most interesting of the venture-capital organizations is the American Research & Development Co. established in June 1946. This company was financed through the sale of its stock publicly, and therefore represents the first attempt to give the ordinary investor an opportunity to participate in a spread of venture-capital investments through ownership of the stock of the investing company. The extension of this pattern could greatly increase the supply of capital available to new and expanding small businesses, since the great bulk of the savings today is in the hands of the middle-income group.

We believe that the establishment of these organized venture-capital groups is a most significant and wholesome development. While the aggregate capital of those thus far established is entirely inadequate to meet the venture capital needs of the economy, they do establish a new pattern that may become important. To the extent that they are able to demonstrate that the business in which they are engaged is a constructive and profitable one, others may be expected to set up comparable organizations to the end that there may be an adequate development of private venture-capital sources. It is also worthy of note that the actual capital which these organizations are able to direct into venture capital channels is greater than their own total capital. Individuals and groups familiar with the activities of these firms but not themselves organized for venture capital investments often participate in situations requiring larger investments than the firms themselves wish to make.

Within the broad limits of the purposes common to all the firms, each firm has developed along somewhat different lines of interest, and the nature of its investments varies with the interests of its founders, the background of its personnel, and other considerations. By way of illustration, it may be useful to set forth some of the principles which have been used by our firm as guideposts. No one of these principles is necessarily irrevocable or controlling:

(*a*) We are interested only in enterprises located in the United States and prefer situations involving some new product or process with distinct competitive advantages. The policy against investments outside the United States is a temporary one based upon our belief that we should not endeavor to enter the field of foreign investments until we have established more definitely our objectives and methods in the domestic field.

(*b*) In general, we prefer that new products or processes be past the very early laboratory stages so that they do not have substantial experimental work to be completed before commercial development can commence.

(*c*) There is no lower limit to the size of investment in which we are interested. If capital substantially in excess of $500,000 is required, the firm will ordinarily seek the assistance of other capital sources to provide the necessary funds.

(*d*) We do not require voting control of companies in which we become interested, but we would at least expect to be influential in the company's affairs.

(*e*) We are ordinarily not interested in buying securities which merely represent a change of ownership, since that defeats our primary purpose of supplying capital to new enterprises. Exceptions might be made to this practice if the change of ownership involved the provision of additional capital or some other beneficial contribution to the company.

(*f*) We place great stress on the quality of management in the companies in which we invest. If the management is not adequate, it must be clear .to us that satisfactory management can be obtained.

The foregoing principles are in addition to such general considerations as the economic outlook, the outlook for the particular industry, and the invested position of our firm. We have not as yet arrived at any generalizations concerning the relative attractiveness of the various major fields of business. However, we naturally feel more competent to judge the merits of investment opportunities which relate to fields in which we already have an interest and for that reason are likely to look upon proposals falling within these fields with slightly more favor. Broadly categorized, some of the industries in which we presently have investments are chemical, frozen citrus concentrates, oil and gas, gas transmission, newsprint, rubber, high vacuum research, and building materials.

Opportunities and investments.—Since February 1, 1946, there have been presented to J. H. Whitney & Co. a total of approximately 2,100 propositions. Of these, about 35 percent were rejected immediately as outside the scope of the firm's interest or clearly lacking in merit. Another 52 percent were rejected after an initial review by the partner or staff member to whom the venture was assigned. Twelve percent were rejected after full consideration and study, and 17 propositions out of the 2,100 or slightly less than 1 percent resulted in investments. The investments range in size from $5,000 to $1,250,000, and the interests obtained by the firm range from less than 1 percent to 50 percent. For the most part, however, the investments have been in the range of $100,000 to $500,000 and the interests obtained from 10 to 40 percent. In determining the size of our initial investment in a venture, we must bear in mind that probably the company will require additional funds; if it succeeds it will need funds for added plant capacity and working capital while if it encounters difficulties new funds may be needed to continue operations in the hope of ultimate success.

While it is too early to judge the results of these investments from a financial standpoint, it may be of interest to make a tentative appraisal of them as they appear at this time. Of the 17, 2 have been extremely successful; 5 have been successful or moderately successful and have resulted or in all probability will result in some profit to the firm; 2 appear likely to result in some loss less than total; 4 look as though they may possibly involve a total loss; 1 has already resulted in a total loss; and 3 have progressed insufficiently for appraisal.

While all of these investments may be broadly classified as venture-capital investments, they cover a comparatively wide range as to type and degree of risk. Seven of the companies are devoted to the exploitation of new industrial processes or products, so that there is substantial risk of total loss in any one of these investments. To justify investments of this class the opportunities for gain should be correspondingly high, and even then it is very difficult to raise the capital required to launch this type of project. Three of our investments were made in industrial companies which, at the commencement of our participation, had demonstrated their ability to make a satisfactory product but had not progressed to the point of having established a successful commercial operation. Capital for this type of company involves less risk than for the type previously mentioned, but it still cannot be raised, generally speaking, through normal banking or investment banking channels. Two of the three companies mentioned have now demonstrated their ability to conduct successful commercial operations and both are in a position today to do any necessary financing publicly. The third of these companies has failed.

Four of our investments are in companies which had demonstrated prior to our investment their ability to conduct commercial operations successfully but which had, at the time we became interested, sufficient growth possibilities to justify an interest on the part of a venture-capital firm. These investments are comparatively conservative as risk-capital investments, and this type of venture capital is of course much easier to raise than that involved in the types of cases previously mentioned. Two of our investments have been made in natural-gas transmission companies. In recent years such companies have been comparatively more attractive to capital at an earlier stage than other types of new enterprises. This is due to the fact that at the time the bulk of the capital is required, the company's gas supply, market, and price are established and it has obtained the required permission of the Federal Government which in effect assures a minimum return on invested capital. Since construction costs and difficulties can be appraised with reasonable accuracy, the risk is reduced to the point that both debt and equity financing have been comparatively less difficult for this type of venture. One of our investments is in oil and gas exploration. Here the risk varies with the type of exploration involved—proven, semiproven, or wildcat. However, the flow of capital into this type of activity, even where the risk is high, has been greatly increased and accelerated due to special tax features such as the provisions relating to drilling deductions and depletion allowances.

The future development of venture-capital sources.—We believe on the basis of 4 years' experience that the organized investment of venture capital can be a profitable, constructive, and interesting business. However, the nature and difficulties of the business should be clearly understood. To select new ventures wisely from the mass of opportunities presented at a time in the stage of the venture when there are so few objective criteria upon which to rely is not easy. After the initial selection has been made, there are several years of hard work with the company to which to look forward. At the time a company requires venture capital it is generally at its most difficult and critical stage, and venture capital investors must in their own interest be in a position to give their companies continuous and substantial assistance in the form of guidance and advice as well as funds. Thereafter, if the company is successful, there is the problem of disposition of all or a portion of the investment in order that the funds of the investor may be available for other new ventures. If the company is less successful the work-out period is of course prolonged. If the company fails, there is the difficult and unpleasant job of liquidation. The number of failures must not be permitted to mount to a point where they cannot be more than offset by successes, for financial success is essential if a venture-capital organization is to prove its worth in the economy. Despite the difficulties inherent in the investment of venture capital, if we may assume a reasonably congenial economic and political environment, we believe that the number of organized venture-capital sources will continue to grow, and thus the American economy will prove again its ability to meet changing conditions and demands.

The suggestion has been made from several sources that the Federal Government undertake to remedy the venture-capital deficiency through direct participation in investments. It is our opinion that such a course would be unwise. Problems involved in the making and following of venture-capital investments would seem to be peculiarly ill-adapted to direct Government action. The political forces, administrative limitations, and responsibility to the public necessarily inherent in the operation of Federal agencies, plus the use of public funds, are not consistent with an efficient handling of the problems involved in venture-capital investments. No public agency could select its ventures with complete freedom from political influence, and participation by a Government agency in the affairs of management to the extent required in this type of investment is wholly irreconcilable with present-day American political and economic practices.

If the committee or the Congress should feel, as a result of its investigation, that Federal action should be taken to accelerate the development of new venture-capital sources, it is our view that legislation aimed at providing a more congenial environment for the development of private sources would be immeasurably preferable to direct action. J. H. Whitney & Co. is a comparatively small organization and research personnel is not available to study proposed legislation in the field of our operations. Therefore, we are not qualified to make definitive recommendations, but the following are illustrative of thy types of action which the committee might wish to consider in this regard:

1. Allowing the individual taxpayer some form of tax credit on dividend income, based upon taxes paid by the corporation. It should be noted that this type of allowance would do far more to stimulate the flow of capital into equity investments and venture-capital channels than the suggestion sometimes made in this regard that corporations be allowed some type of deduction on account of dividends paid.

2. Oppose proposals for increasing corporate income taxes and, to the extent that it may be made possible through decreased Federal expenditures, consider the reduction of corporate taxes.

3. Allowance of accelerated depreciation rates on new plant and equipment in order to reduce initial risks.

4. Study the possibility of strengthening the patent protection afforded new processes and developments. The general lack of confidence in the strength of any patent, which stems from the present attitude of the administration and courts toward patents, unquestionably adds greatly to the difficulty of financing any new venture or enterprise based upon invention. If the antitrust machinery were relied upon to avoid the improper use of patents in restraint of trade, instead of attacking the validity of patents as such, it would be possible for the venture-capital investor to consider more favorably the financing of new technological developments independently conceived.

Serious consideration of legislation along the lines of any one of the proposals set forth above would necessarily involve extensive study of the economic and political ramifications and the limitations which such legislation should have. It would be possible, for example, to sharpen any one of the proposals so that it applied more directly to the stimulation of the flow of venture capital into new enterprises and, therefore, to the type of investment in which J. H. Whitney & Co. is primarily interested. However, since we are not in a position to submit and support detailed recommendations, the possibilities have been stated in their broadest form.

The CHAIRMAN. We will now adjourn until 10 o'clock tomorrow morning.

(Whereupon, at 4:50 p. m., the committee adjourned, to reconvene at 10 a. m., Tuesday, December 13, 1949.)

VOLUME AND STABILITY OF PRIVATE INVESTMENT

TUESDAY, DECEMBER 13, 1949

CONGRESS OF THE UNITED STATES,
JOINT COMMITTEE ON THE ECONOMIC REPORT,
SUBCOMMITTEE ON INVESTMENT,
Washington, D. C.

The subcommittee met, pursuant to adjournment, at 10:35 a. m., in the caucus room, Senate Office Building, Senator Joseph C. O'Mahoney (chairman) presiding.

Present: Senator O'Mahoney.

Also present: David Scoll, special counsel to the committee, and Theodore J. Kreps, director of staff.

The CHAIRMAN. The committee will come to order.

I have a rather interesting letter this morning from Mr. Leroy Lincoln, president of the Metropolitan Life Insurance Co.

It will be remembered that when Mr. Lincoln testified last Wednesday, the chairman of the committee discussed with him the failure of large life-insurance companies to provide loan funds for small business. And in response to one of the questions of the chairman, Mr. Lincoln expressed the great desire of his company to provide such loans if they were available and if they met the requirements.

And in the discussion, Mr. Hagerty, his assistant, said:

> But going back to our desire to loan, if the local bank would take 10 percent of a loan and stay with it as long as we stay with it, we would be glad to do it. They do not bring them to us. I think small loans must originate locally.

To that statement I agree, and then Mr. Lincoln said:

> If the Small Business Committee would get around and talk to Mr. Hagerty we might get somewhere.

Whereupon the chairman remarked:

> This is really quite a forum, and if the Metropolitan Life Insuracne Co. with its executives here is willing to say, as Mr. Hagerty has just said, to the small local bankers of the United States, "If you will take 10 percent of the amount of a good loan for which application is made, we will take the other 90 percent, provided you will stay with it and service it."
>
> Is that your proposition?

And the colloquy went on:

> Mr. HAGERTY. Provided the loan meets the legal qualifications we have.
>
> The CHAIRMAN. Of course, provided that it meets the legal qualification, and one which you deem to be a good loan.
>
> Mr. LINCOLN. I think you have opened up a big door here because my two financial advisers say they will accept it just as you put it.
>
> The CHAIRMAN. Let's get it on the record. Mr. Ecker, you are saying that you will accept that?
>
> Mr. ECKER. Yes, sir.

The CHAIRMAN. And Mr. Hagerty has already said it with the approval of Mr. Lincoln.

Mr. LINCOLN. And the approval of Senator O'Mahoney. I want you in it, too.

The CHAIRMAN. I am in it. I am promoting it.

Mr. LINCOLN. All right.

The CHAIRMAN. Because I do sincerly believe if little-business applicants have a good thing, they ought to have access to the savings of the people.

Then, on Friday last, I announced here, I think at a press conference, that it would be my purpose to correspond with the Small Business Advisory Committee which had testified before us last Tuesday—the Small Business Advisory Committee of the Department of Commerce—and with the heads of the various insurance companies to see if we could not start something of this kind.

So last week I dictated letters to Mr. Lincoln and others, copies of which we will put in the record this morning.

(The letters referred to are as follows:)

DECEMBER 10, 1949.

Mr. LEROY LINCOLN,
President, Metropolitan Life Insurance Co.,
New York, N. Y.

DEAR MR. LINCOLN: The newspaper response to the suggestion made at our hearings while you were testifying that the Metropolitan Life Insurance Co. would welcome participating loans to small business on a basis of 90–10 with local banks, makes me feel that we should not overlook pursuing the matter. If a practical plan can be worked out to do this, it will materially help in solving our problem. So, taking advantage of your suggestion that you would like to talk to the representatives of small business, I have written Mr. Harry L. Miller, chairman of the Small Business Advisory Committee of the Department of Commerce, as per the enclosed.

You may remember my observation that small-business executives appear to regard the large New York insurance companies as rather distant and formidable institutions, to which your answer was that the Metropolitan is interested in making more small-business loans. This same interest in encouraging the small-business borrower was also expressed by Mr. Whipple of the Mutual Life Insurance Co. of New York, who suggested that study be given by the insurance companies to the Kaplan plan.

It occurs to me that if the large insurance companies were to establish machinery to deal specifically with small-business requirements, somewhat in the manner that Metropolitan operates in the farm field, and would let it be known to small business that the great institutional investors were interested in their problems, we might go a long way in dealing with one of the critical factors affecting the variability of the flow of savings into private investment.

In any event, I shall try to arrange a conference between the insurance group and the small-business group. I am therefore taking the liberty of sending a copy of this letter to all of the insurance company representatives who testified at the hearing, as well as to Mr. Miller, chairman of the Small Business Advisory Committee of the Department of Commerce.

Very truly yours,

JOSEPH C. O'MAHONEY,
Chairman.

DECEMBER 10, 1949.

Mr. HARRY L. MILLER,
Chairman, Small Business Advisory Committee, Department of Commerce,
Chester, Pa.

DEAR MR. MILLER: In response to questions which I put to them during the course of the hearings, the insurance executives who have appeared before the Investment Subcommittee have indicated their willingness to sit down with members of the Small Business Advisory Committee to discuss ways and means of meeting the needs of small business for loans and equity capital through existing private investment channels. If it were possible to meet these needs adequately through private channels, it would not be necessary for the Federal Government to enter this field.

I believe your advisory committee should pursue this question with the insurance companies and, of course, representatives of the banking world to explore the possibility of a solution ot the small business capital requirement problems through the private investment institutions.

I wish you would inquire of the members of your committee and advise me when and where a meeting with the representatives of the private lending institutions could be arranged.

I am enclosing copies of my letters to Mr. Leroy Lincoln, of the Metropolitan Life Insurance Co., and Mr. Oliver Whipple, of the Mutual Life Insurance Co., of New York.

Very truly yours,

JOSEPH C. O'MAHONEY,
Chairman.

DECEMBER 10, 1949.

Mr. OLIVER M. WHIPPLE,
Financial Vice President,
Mutual Life Insurance Co. of New York, New York, N. Y.

DEAR MR. WHIPPLE: You suggested during your appearance before our Subcommittee on Investment that you believed that the lending institutions as well as the committee might examine thoroughly the proposals of Dr. A. D. H. Kaplan for a capital bank. You will recall that Mr. Lincoln, of the Metropolitan Life Insurance Co., expressed a similar interest on the part of his company making small-business loans.

I have written to Mr. Harry L. Miller, chairman of the Small Business Advisory Committee, as per the enclosed letter. A copy of my letter to Mr. Lincoln is also enclosed.

The suggestions made by you and Mr. Lincoln are most constructive and I am anxious that the matter be actively pursued to see if there is not some way of dealing with the pressing financial problems of small business through the medium of private investment institutions rather than through the direct entrance of the Federal Government into this field. It is my belief that if this problem cannot be handled successfully through private investment channels, the demand for some sort of Government financial assistance to small business will be irresistible.

I am taking the liberty of sending a copy of this letter, along with my letters to Mr. Lincoln, of the Metropolitan Life Insurance Co., and Mr. Harry L. Miller, of the Small Business Advisory Committee, to the other insurance executives who appeared.

Very truly yours,

JOSEPH C. O'MAHONEY, *Chairman.*

The CHAIRMAN. This morning I received the following letter from Mr. Lincoln. It is dated December 12, yesterday, addressed to the chairman of the committee:

> I see by the papers that you are proposing to invite a conference of some of the life-insurance companies and/or the Small Business Committee in re the proposal that we developed during the testimony the other day.
>
> I may have "beaten you to it" by having already sent a wire to Mr. Miller, chairman of the Small Business Committee, inviting him to a conference with us on this same subject. If that eventuates that may lay the ground work for the very conference which you are suggesting.
>
> You will be interested to know that we have had literally hundreds—and I mean hundreds—of letters from all over the country making inquiry about this Metropolitan plan. We are in the process of setting up machinery to take care of these inquiries on a case basis, and shall certainly develop the fact that we mean business whether we do or do not find any available investments.
>
> In closing, let me thank you again, and your staff, for the courtesy with which we were received while before the committee last Wednesday.
>
> With kindest personal regards, I am
>
> Sincerely yours,
>
> LEROY A. LINCOLN, *President.*

We might have a little debate with Mr. Lincoln on whether or not this is the Metropolitan plan or the Investment Subcommittee plan, but whomsoever's plan it is, if it gets started and makes funds available for small business, I think it would be a decided step forward in this matter of providing funds for little and local business.

On the following days last week, on Thursday and Friday, I took the same suggestion up to the representatives of other insurance companies, notably Mr. Whipple, of Mutual. Well, I think I questioned Mr. Whipple on the stand and others I spoke to. And they all seemed to be very cordial toward the idea.

So we may have a participating plan of local banks and big insurance companies to channel at least some of the savings of the people back into the areas in which they originate.

Mr. Hackett, we are ready to hear you proceed.

Mr. HACKETT. Thank you, Mr. Chairman.

Mr. SCOLL. Before Mr. Hackett proceeds, Mr. Chairman, I think it might be well to state for the purposes of the record here that we invited him to appear before us and to give the committee an appreciation of the impact of inheritance taxes and the Federal estate taxes on small- and medium-sized business. Mr. Hackett has been a trust officer and investment counsel and estate planner and has prepared the material.

The CHAIRMAN. You may proceed, sir.

STATEMENT OF W. T. HACKETT, VICE PRESIDENT, HUNTINGTON NATIONAL BANK, COLUMBUS, OHIO

Mr. HACKETT. I assume that for the record you want my name, which is W. T. Hackett. I am a vice president and trust officer of the Huntington National Bank of Columbus.

With your permission, Mr. Chairman, I have a prepared statement which I should like to read. It will keep me on the track. Inasmuch as the points I will try to develop depend on facts, it is necessary that I use a prepared statement. If there are any questions, I assume they will be brought up later.

The CHAIRMAN. That is right; you may proceed with the statement.

Mr. HACKETT. It is my understanding that this committee is now inquiring into what may be done to promote the investment of private capital inequities—both those of the larger companies that are listed and traded in on our security exchanges, and those of the smaller companies which are closely held and not listed on any exchange.

I should, therefore, like to point out to you gentlemen certain factors, which are little publicized although becoming increasingly dangerous to our economy, and which have a very definite bearing on the growing reluctance of private capital to seek investment in the smaller closely held corporations, partnerships, and proprietorships.

Furthermore, I shall also try to show you that today it is virtually impossible, in many cases, to maintain an investment in such a business enterprise for any considerable length of time—certainly not from this generation to the next.

By way of qualifying myself, I should explain that I have been active in the fields of investment and tax counsel since 1935. I have specialized in Federal estate, gift, and income taxes, and State inheritance taxes, as they may have a bearing upon the individual's over-all financial position; and particularly his desires and plans for transferring his properties to his heirs.

During this past 15 years I have worked with some 400 to 500 individual estates, assisting the family heads and their counsel in arranging their financial affairs so that their properties would be subjected to a minimum tax impact during their lifetimes; and after their deaths in passing to their heirs. In other words, I am a so-called estate planner.

For some years, prior to my taking my present position with the Huntington National Bank, I was a partner in a midwestern firm of investment counselors, who are affiliates of Scudder, Stevens & Clark, of New York and Boston. I handled our several hundred clients' tax problems.

From this connection, as well as my present one, I had an opportunity to acquire a first-hand knowledge of the investment problems which confront the average investor today, and also the tax problems that afflict him.

In working with the 400 to 500 clients that I mentioned, I have in every case had a complete, detailed inventory of their assets, as well as their spouses' and children's, to work with. This has given me an excellent opportunity to determine the investment preferences and objectives of the average person who has property today; and the problems he has to cope with in trying to conserve his property.

I would like to digress for a moment and stress one point, and that is that the type of person I have been working with is not the so-called large investor who may have a million dollars or more, but, if there is an average, he is the average man of wealth who is probably worth, if I may hazard a guess, two to three hundred thousand dollars on an average.

They, as a group, are interested—speaking broadly of their major objectives—in three things: First, of course, in securing the largest possible income that they can during their lifetime, as a good many of us try to do. Secondly, they are interested in building up principal to provide security for themselves during their lifetimes; and, thirdly, they are interested in providing security for their heirs after their death.

As we all know, everyone who has accumulated an estate—thus becoming an investor—since 1932, has done so in the face of serious and increasing odds, in the form of ever-mounting income taxes. As a consequence, with the exception of those who have made their money in recent years out of the professions and farming, post-1932 wealth has largely been created by the development and operation of small closely held corporations, partnerships, and proprietorships. As wealth, it does not take the form of cash, or listed marketable securities; corporate and personal income taxes have prevented that.

The average man with an interest in a small business has, however, plowed earnings back into his business to the maximum extent permitted by law, and a good portion of his accumulated wealth is, therefore, now represented by inventories, receivables, machinery, and bricks and mortar.

This investment, in most cases, provides him with an adequate, and in some cases better-than-average, income so long as he lives. However, today's income tax laws preclude his taking down from the business—if it is a corporation—much more than he needs to live on; and excess income is usually plowed back into plant expansion—

not into a cash surplus—to the extent that section 102 of the Internal Revenue Code permits such retention of corporate earnings.

Then, as happens to every man, the inevitable one day occurs, and he dies. At this point one of the many inconsistencies of our tax laws singles him out—because of the nature of his principal investment, a small closely held business—and in many, many cases severely penalizes him, either by destroying that which he has spent years in building or at best by forcing his estate to dispose of some part of it, often at a sacrifice price.

This comes about due to the following reasons: As you know, when a man dies his properties must be inventoried and appraised for Federal estate tax purposes if his assets are worth more than $60,000. And in most States they require appraisal for State inheritance taxes regardless of net worth.

Let us take the case, then, of an individual—who has an interest in a closely held corporation—who dies leaving an estate, the value of which is in excess of $60,000. The decedent's executor is given the option under Federal estate tax laws of valuing his assets either as of the date of death or 1 year after, thus enabling him to choose the lower of the two and minimize estate taxes. The Federal state tax laws and regulations accept as a value for tax purposes the market value for securities listed on certain exchanges and in some cases certain over-the-counter market values.

Furthermore, it is provided that if an asset is sold during the 12-month period immediately succeeding death, the sale price is acceptable for tax valuation purposes, if the executor has elected to value the estate 1 year after death.

In the case of unlisted securities, however—such as closely held corporation shares, or an interest in a partnership, or a proprietorship—not disposed of within 12 months after death, the Federal estate tax laws and regulations are far from exact in prescribing the method whereby their tax value shall be determined. They specify that the fair market value shall be established for such assets, and this is generally defined as being "the price at which property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell."

As a consequence, where an interest in a closely held business is retained by an estate almost invariably a question is raised by the authorities as to its fair market value, for tax purposes. Obviously, the higher the value that is established, the greater will be the tax.

Let us take a typical case, where the executor schedules a decedent's interest in a close corporation at the value set by court-appointed appraisers, which value we shall say is book value. This value must be supported with data showing the net worth (book value), earning power over a period of years, dividend-paying capacity—if it is stock, and the company's relative position in its industry. The taxing authorites then usually first compare book value with a capitalization of the average earnings, for the past 3 to 5 years—capitalized at from 6 to 20 percent, depending upon the nature of the business—in order to determine which value is the higher. Recent sales of shares—if bona fide and representative—and a comparison with the listed market values of shares of competitive companies are also factors which are supposed to be considered, although they are not deemed to constitute conclusive evidence as to fair market value.

There then usually follows extended and costly controversy or litigation, the taxing authorities claiming a high—and in many cases arbitrarily so—value and the representatives of the estate seeking to establish a low value. As in most tax controversies, however, relatively few cases reach the courts, most of them being settled by a compromise.

As a general rule, it may be stated that the taxing authorities usually claim as tax value the higher of book and a capitalized earnings value, and the ultimate compromise is seldom lower than the mean of the two values.

To support this statement, I should like to offer in evidence the values established in a partial list of cases that have reached the courts, and are thus a matter of record. I again call attention to the fact that for every case litigated, there are many settled by the compromise method, and therefore the values claimed and finally agreed upon are not readily available.

You have, in separate form, outside of the prepared statement, a list of tables which you can either refer to or you may use the ones in the statement.

(Chart A is as follows:)

CHART A

Name of case	Value per share		
	Taxpayer	Commissioner	Court
Hettie M. Stroh, TC Memo, 1-19-43	$381.56	$620.40	$465.00
R. S. Buchanan, TC Memo, 2-8-41	160.00	478.00	478.00
Wishon v. *Anglim*, 42 F. Supp. 259	540.00	836.36	584.23*
	640.00	1,023.95	678.55*
Sarah H. Bradley, TC Memo, 8-6-43	121.00	430.00	275.00
True, Exr. v. *U. S.*, 51 F. Supp. 720	7.50	10.00	9.70
Bank of California v. *Comm'r.*, 133 F. (2d) 428	135.63	179.45	179.45
Estate of T. C. Thompson, 3 BTA 902:			
Common	55.00	234.00	200.00
First preferred	75.00	85.00	85.00
Second preferred	65.00	75.00	75.00
G. F. Milton, 17 BTA 380	24.50	174.00	100.00
P. C. Pendleton, Exrs., 20 BTA 618	150.00	400.00	400.00
Brooks v. *Willcuts*, 9 F. Supp. 19	140.00	175.00	175.00
Estate of Hogan, TC Memo, 4-6-44	1,125.00	2,100.00	1,459.00
Newell, Exrs. Ingalls v. *Commissioner*, 25 BTA 773	154.10	250.00	242.44
	75.00	100.00	75.00*
Waterman, J. B., BTA Memo, 12-12-41	42.50	100.00	42.50*
	370.00	1,250.00	600.00
Kennedy, Exrs., 4 BTA 330	0	60.00	10.00*
Am. Trust Co. (*Estate of Bennie*), 13 BTA 105	142.00	167.62	167.62
Forbes v. *Hassett*, 124 F. (2d) 925	0	7.46	6.84
Nat'l Bank of Oneonta, Exr., 17 BTA 654	500.00	600.00	500.00*
Bob v. *Commissioner*, TC Memo, 6-7-45	300.00	332.00	300.00*
Schroth, Exrs., 5 BTA 326	175.00	332.00	300.00
Walter, H. H., Exrs., 2 BTA 453	130.00	170.00	170.00
Estate of H. M. Springer, 45 BTA 561	200.00	290.00	290.00
Estate of W. Maxwell, TC Memo, 11-3-44	9.50	11.00	10.50
	75.50	76.50	76.50
Vandenhoeck, Estate of P. M., 4 TC 125	14.00	85.00	40.00*
	11.93	12.50	12.50
Johnston, H. L., TC Memo, 6-22-43	31.00	50.00	36.00*
Harter, Exr. Estate of Bromely, 16 BTA 1322	100.00	330.00	330.00
	1,000.00	1,800.00	1,800.00
Laird, Exrs., 38 BTA 926	758.00	1,760.60	1,000.00
	6,046.00	15,043.66	8,500.00*
C. W. Edwards, Exrs., 31 BTA 879	200.00	310.00	310.00
Estate of Fairchild, 9 BTA 416	138.15	177.00	177.00
Hancy, Exr. Hone, 17 BTA 464	300.00	345.00	345.00
Hanscom, Exrs., 24 BTA 173	50.00	100.00	100.00

CHART A—Continued

Name of case	Value per share		
	Taxpayer	Commissioner	Court
Irvings Bank, Columbia Trust Exrs. Estate of O. Jaeger, 16 BTA 897	62.23 500.00	90.00 735.00	90.00 735.00
Estate of W. McDougall, 45 BTA 803	50.00 25.00	100.00 50.00	100.00 50.00
Day, Exr., 3 BTA 942	100.00	175.00	175.00
Gessell, Exrs. Kelly, 41 F. (2d) 20	311.60 100.00	475.00 110.00	475.00 110.00
Dougherty, Admr. Keenan, 4 BTA 1232	540.00	696.00	696.00
Good, H. B., BTA Memo, 9-25-42	90.00 35.00	150.00 135.00	115.00* 61.00*
Hazelton, B. F. Jr., TC Memo, 7-14-43	41.25	46.25	43.00*
McIlhenny, F. P. Exrs., 22 BTA 1093	50.00 46.66	71.00 62.50	60.00* 50.00*
Stearns, Admr., 1 BTA 1252	300.00	351.94	351.94
Worcester County Trust, Exrs., J. Smith, 134 F. (2d) 578	15.46	35.00	35.00
Union Trust Co. of Pittsburgh, Exrs., Estate of Owens, 19 F. (2d) 362	110.00	140.00	110.00*
Schoenheit, Exrs., Estate of Von Ruck v. *Lucas*, 44 F. (2d) 476	58.72	149.00	149.00
Stebbins, Admr., 1 BTA 1157	1,000.00	1,725.00	1,725.00
Kanawha Banking & Trust Co., Exrs., F. M. Staunton, 29 BTA 376	150.00	857.00	150.00*
Burda, L. J., TC Memo., 7-21-43	3.00	10.00	5.00*
Anthracite Trust Co., Admr., (Estate of J. J. Brown), 3 BTA 486	110.00	500.00	400.00
Holmes, Exrs., 22 BTA 757	160.00	400.00	245.00*
Richardson, J. S., TC Memo, 11-30-43	33.00	42.62	42.62

Mr. HACKETT. I have indicated with asterisks to the right those cases that were finally settled for a value no higher than the mean of the value claimed by the taxpayer and the Commissioner.

The CHAIRMAN. Settled for what?

Mr. HACKETT. For a value no higher than the mean of the two values—the high and the low values claimed.

You will note that out of these 62 cases, 19 were settled at or lower than the mean of the two values—19 out of 62—and only 6 of these were settled on the basis of the taxpayers' claimed values. In other words, in 66 percent of the cases the Government's claim was sustained, 10 percent were decided in favor of the taxpayer, and 24 percent were compromised at a figure substantially higher than that claimed by the taxpayer. It would seem that the odds are against the property owner in these disputes.

The CHAIRMAN. There is no such thing as arbitration of such controversies, is there?

Mr. HACKETT. If I understand that by arbitration you mean that the representative of the estate and the representative of the department get together, with an arbitrator present, no. Your final resort is the courts in all cases.

Mr. SCOLL. When you say your final resort is the courts, you mean the tribunal of first resort is, of course, the Tax Court?

Mr. HACKETT. That is right.

Mr. SCOLL. But that is after the estate representatives have exhausted the possibility of compromise with the technical staff?

Mr. HACKETT. That is correct. And in those cases which are compromised—I again would like to point out—there are no records on those cases that are available to my knowledge. On compromise cases

I do not know how the value that is finally arrived at is determined, or at what level they are usually settled.

But from my own personal experience, rather limited it is true, I know that the compromise cases are always substantially higher than the taxpayers' claimed values.

Mr. SCOLL. They would necessarily be higher.

Mr. HACKETT. They would have to be or there would not be any question.

Mr. SCOLL. That is right.

Now in the question of compromise, as you say, you do not know how many cases are compromised. Have you ever had occasion to find out how many cases were contested in proportion to the number of estate tax returns filed in any period?

Mr. HACKETT. No; I have not. I am trying to think how you might find such a record. Again, I can only rely on my own experience which, I say, is limited. But I know that in almost every case that I have been familiar with, and which has been administered within the last 5 years, where there has been a close corporation business interest involved there has been a controversy as to the tax value of that property in the estate.

Mr. SCOLL. You say in almost every one you have been involved in?

Mr. HACKETT. That I am familiar with; yes, sir.

Mr. KREPS. Could you tell us how the taxpayer sets his value?

Mr. HACKETT. Usually no lower than book value. There are exceptional cases, however, where, for example, if a man has an equity in a small steel corporation his executor may attempt to set a value for his shares that is probably lower than their book value, if the listed stock of the big steel companies are at that time selling at some discount off their book values. In such case the executor may attempt to claim the same discount for the value of his stock. But I think it is fair to say that by and large a figure no lower than book value is one that is usually claimed by decendents' estates.

Mr. SCOLL. In the case of corporations whose securities have no listed value, which is the type of corporation we are primarily talking about here, the code and regulations establish fair market value as the valuation basis, do they not?

Mr. HACKETT. Right.

Mr. SCOLL. So your controversy with the Bureau, if any, is over the meaning of fair-market value?

Mr. HACKETT. What the Bureau considers constitutes fair-market value.

Mr. SCOLL. Now the regulations and memoranda and opinions on the question of fair-market value of estates are pretty prolific, are they not? There is quite a body of authority on the question of what is a fair-market value of such types of businesses?

Mr. HACKETT. Mr. Scoll, almost every case is different. For example, you will have certain factors weighted more heavily in valuing stock of a steel company than you will have in the case of a mercantile company's stock. There is no conclusive law defining and setting out what in every case shall be deemed to constitute fair-market value.

Mr. SCOLL. No; because it is a question of fact.

Mr. HACKETT. Right.

Mr. SCOLL. But the precedents are quite numerous for different types of businesses, are they not?

What I am getting at is that as an estate planner you are in a position, by making a review of the cases that have been decided by the Bureau and by the Tax Court and by the Federal courts, to advise counsel for the estates—because you would not practice law?

Mr. HACKETT. That is right.

Mr. SCOLL. But to give some idea of what estimate of fair-market value which the Bureau might approve in the situation is likely to be.

Mr. HACKETT. That is true.

Mr. SCOLL. You know what the precedents are.

Mr. HACKETT. That is true.

Mr. SCOLL. So that generally speaking, even though it is a difficult question, it is not one in which you are entirely in the dark.

Mr. HACKETT. That is absolutely true. If it can be called a formula, there is the rule of thumb that I set out earlier, which is the higher of book value or capitalized earnings value, which is usually the Bureau's take-off point, and we know we have a chance in the average case of winding up either at that figure or at some figure between that high and the low value claimed by the estate. You cannot pin it down much closer than that. While we can estimate the top limit, we point out to our clients that the tax value of their holdings will probably fall at that figure or at some point lower but not at the lowest figure, as these cases that have been submitted in tabular form would seem to bear out.

The majority of these cases were decided at the upper figure.

Does that cover the question?

Mr. SCOLL. Yes.

The CHAIRMAN. Now the compromises in most of these cases are negotiated with whom?

Mr. HACKETT. The representatives of the Internal Revenue department. The representative of the estate, the executor or administrator, and the department representative sit down across the table from each other. Their discussions seldom involve an open-and-shut question. It is usually a case of "We will concede this if you will concede that." And thus the value you finally arrive at is a "compromise."

The CHAIRMAN. But the representatives of the internal revenue collector, are they the individuals who in the first instance have established the value for which the Internal Revenue Bureau contends?

Mr. HACKETT. Right; they are usually the local men, Mr. Chairman, who review the estate tax return. Then on the basis of the values the executor has submitted in the return, they agree or disagree—usually they disagree.

The CHAIRMAN. Does that tend to bring about in the settlement of such controversies a conflict, so to speak, between the representative of the estate contending for the lowest possible amount and the representative of the collector contending for the largest possible amount?

Mr. HACKETT. It invariably brings about a conflict.

The CHAIRMAN. Of course, it brings about a conflict, but do we start from the extremes at both ends?

Mr. HACKETT. Yes; in most cases you start at the extremes because each one is trying to use his value as a bargaining position and work toward a compromise.

The CHAIRMAN. Would it be at all feasible or practicable to have such negotiations carried on by boards or groups within the Internal

Revenue Bureau appointed especially for the purpose, before whom both the collector who sets the original appraisal and the estate representative who set the appraisal from the point of view of the estate should appear to argue their cases?

Mr. HACKETT. You have such men in the employ of the Department now, Mr. Chairman. You have the so-called conferees in the Department who take the evidence submitted by both sides and weigh one against the other, and attempt to work out a compromise. But still, in many cases, after the conferee has done the most he can do, you still have a conflict. And in some cases, therefore, you go to the courts.

However, I believe a majority of the cases are decided by arbitration, worked out by the conferee between the Department representative and the representative of the estate, but cases so settled are the ones, I again say, that do not come into the record, and they are usually settled at a higher value than the estate claims.

The CHAIRMAN. You do not desire to imply any special criticism of the Internal Revenue Bureau when you say that only a small percentage of these cases which you have listed were settled anywhere close to the taxpayers' original figures?

Mr. HACKETT. No; my criticism is not of the Internal Revenue Department, it is of the system, or the law, I should say, which permits this type of controversy to arise. The regulations and the Internal Revenue Code are definite, for example, in the case of valuing listed securities, where you take the mean between the high and the low sales price as of a given date. But when you come to this particular type of asset in an estate, a closely held business interest, you are wide open, and it is any man's guess as to what tax value will be claimed for it.

The CHAIRMAN. How would you improve the law?

Mr. HACKETT. About the only way you could do so would be to attempt to work out a formula, which might still work a hardship, but not as consistently as the present method does, on the taxpayer. Such a formula might, in the case of close corporations, arrive at a maximum value by taking the mean of the book and capitalization of earnings values. In other words, set a specific formula so that every close corporation investor would know exactly what the maximum value of his equity would be for estate-tax purposes in the event of his death. He does not know today.

Mr. SCOLL. You are objecting then to the concept of fair market value?

Mr. HACKETT. That is right; the present definition leaves the question of tax value wide open.

Mr. SCOLL. If you tried to apply strict rule to a thing like the value of shares in a family-controlled corporation, would you not find in a great many cases that the formula resulted in a value which may be far off from the real value?

Mr. HACKETT. No. I have not made myself quite clear. My thought would be, if you used a formula, it should set the maximum tax value from which point you would bargain down. You would, it is true, take into account other factors in valuing unlisted securities, as you do in the case of listed securities. For example, the "blockage" element. Presumably some weight should be given to the fact if a man owns the controlling interest in a close corporation rather than a minority interest, because it is probably more difficult to sell, unless sold at a substantial discount.

You should probably also, as under the present law, be permitted to offer in evidence a comparison, even though you are using the formula, to show that competitive corporation stocks that are listed are selling at a lower value than that at which they would sell if this formula were applied.

But the only advantage, as I see it, Mr. Scoll, is that if you had a formula you would set the maximum figure which the Government would claim as tax value. Today, this is not the case because the regulations and laws are loose enough to permit the Government to claim in many cases an arbitrarily high value and then start to bargain down from that point.

Now if you required them to start at, let's say, the mean of a capitalized earnings value and book value, you would reduce the point at which the Government begins to bargain, you would thus narrow the spread between the possible maximum claim and the minimum claim.

Mr. Kreps. I am sure you recognize the similarity of this problem to those which we have encountered in public-utility regulations. I have been trying to find a formula, as you have been suggesting, that might replace the fair market value. Because, of course, ordinarily we let the market arbitrate differences of opinion between buyers and sellers, so to speak, or in making valuation of property.

I regret I cannot think of any that is used in the public-utility field and would be applicable other than what you ultimately get here, namely, some sort of a court determination. You certainly would not recommend upset price or prudent investment or, say, a bona fide sales offer on the part of the heirs, would you?

Mr. Hackett. A bona fide sales offer on the part of the heirs? The term is rather inconsistent. The department in most cases has not recognized as establishing value an offer or a purchase by the heirs. They claim it is intrafamily in character and therefore does not establish "fair market value."

Mr. Kreps. I mean the heirs setting a price at which they would be glad to sell to outsiders.

Mr. Hackett. In the absence of an actual sale to outsiders, under the present Internal Revenue Code, any figure which you might claim you would be willing to sell at would not carry very much, if any, weight.

Mr. Scoll. May I make a further point? What you are saying, in effect, is that you want to put a ceiling on fair market value?

Mr. Hackett. Right.

Mr. Scoll. Now have you considered what the effect of that might be on the Treasury's estate tax revenues? By doing so, do you anticipate that the Treasury would lose any estate tax revenue that it would otherwise get by applying freely determined fair market value concepts?

Mr. Hackett. Yes, it would be bound to follow, the Treasury would lose some revenue. I am sorry that I do not have the figure, I tried to dig it up on short notice and I could not find it, but the Treasury

Deparment's revenue from this source in 1948, by comparison with the over-all revenue, is insignificant.

Mr. SCOLL. You mean from estate taxes?

Mr. HACKETT. From estate taxes. It is a very small portion of the total tax take.

Mr. SCOLL. Yes; but every dollar counts.

Mr. HACKETT. That is true.

Mr. SCOLL. Would you repeat again what you would apply as to the upper limit?

Mr. HACKETT. My thought would be—and I say this arbitrarily—a formula that would take into account book value, which, presumably, is liquidating value, and a capitalization of earnings at a rate that would, I imagine, have to vary from industry to industry, and probably from time to time within industries.

Mr. SCOLL. And by company to company.

Mr. HACKETT. And by companies. You could, for example, take an average of 10 years' past earnings of an industry, and determine the average rate of return that it represents, in ratio to the book value of that industry. This average rate of return would then be used to capitalize the earnings of any small company operating in that particular industrial field, when the question of estate tax valuation arose. Then a mean of the particular company's book value, and its capitalized earnings value, at the rate appropriate to its industry, would set the maximum value that could be claimed for estate tax purposes.

The taxpayer should then be permitted to submit as evidence of a lower value than that arrived at by the formula, any other relevant factors—such as the blockage factor that I mentioned, if it applies in his case; or a comparison with the listed stocks of competitive companies.

Mr. SCOLL. Yes. And on that basis you would not give effect, however, to the built-in values, so to speak, that result from the plowing back of earnings and building up the business.

Mr. HACKETT. Reinvested earnings would show up in book value, Mr. Scoll. Whatever had been plowed back would, of course, have increased the book value of the company.

Mr. SCOLL. Yes; that is right.

Mr. HACKETT. So you would be taking the company at any given time on its then basis: Giving consideration to its liquidating value; and the value that would result if some formula were applied whereby you would capitalize its earnings, at a rate consistent with its particular type of industry; and then, take the mean of the two values. That would be your high value point for tax-valuation purposes.

Mr. SCOLL. Have you tried any computation on any cases which you have records of as to what that would result in—the difference between the tax or the valuation actually established and what would have been established under your formula? Have you tried to work that out?

Mr. HACKETT. No; I have not. I have never attempted to reduce it to figures.

The CHAIRMAN. On the bottom of page 2 of your statement, you have a definition of fair market value.

Mr. HACKETT. As given by the regulations.

The CHAIRMAN. I was going to ask about that. That is quoted from the regulations?

Mr. HACKETT. That is right.

Mr. KREPS. And you would substitute for that, which is pretty well accepted in the business world, as I understand it, a somewhat arbitrary formula?

Mr. HACKETT. No; I would supplement it, not substitute for it. A formula would specifically weigh the various pertinent factors; providing a procedure for weighing that they do not have today.

Mr. SCOLL. And your purpose of doing that is so that the businessman can estimate what his taxes are going to be on his estate when he dies; is that it?

Mr. HACKETT. That is right.

Mr. SCOLL. Enable him to look ahead.

Mr. HACKETT. So he will know at any given point just what his estate and his heirs will be encountered with.

My prepared statement will show, as we get into it further, that a great many individuals have been, and are, confronted, whether they know it or not, with the necessity of eventually having to dispose of their holdings in their close corporations, partnerships, and proprietorships at the time of death.

Mr. SCOLL. Yes. It is also possible for such an individual, be he proprietor or principal stockholder, to make provision during his lifetime for the incidence of the tax, perhaps, by making partial distribution in the way of gifts, perhaps by obtaining insurance, and other means, to make sure that when a tax applies there will be a way of meeting it. Is that not so?

Mr. HACKETT. Theoretically, yes, Mr. Scoll. Practically it would not work that way.

You mention the gift method. But it is surprising to find how many men are loath, reluctant, to give away their property during their lifetime, and probably the control of their companies, in order to minimize the impact of death taxes.

Mr. SCOLL. But they have the right to do that.

Mr. HACKETT. They have the opportunity, subject to gift-tax laws, to give up some part or all of the control of their business during their lifetimes if they want to avoid this other problem; yes. But in most cases they will choose the worse of the two evils. They usually decide that they want to retain the control of that which they have built up and that which they are interested in, and have pride in, during their lifetimes, and take the consequences of the tax problems later, when their estates are administered.

Mr. SCOLL. Is it your position that the Bureau of Internal Revenue should give the taxpayer the benefit and the opportunity of electing to control his business and still not pay the tax?

Mr. HACKETT. No; it is not. That, of course, would not be sound. A tax should be paid. It is a question of how much tax and what the effect of paying it will be on the over-all picture, as far as small businesses are concerned.

In my experience—and again I refer you to that which we will come to later in my statement—there are many, many businesses, small, closely held corporations, where the owner has been forced to sell either during his lifetime, or his estate will be confronted with the necessity of selling after his death, or liquidating in the event that they cannot find a purchaser.

I do not contend that the small businessman should be pampered or given special consideration. I think he should be given the opportunity, though, to protect and preserve that which he has built up, because I think it is essential to the over-all economy that small business be protected and maintained in this country.

Mr. SCOLL. Now, when you say small business in this regard, you are talking about businesses which have an estate value of something around in excess of a quarter of a million dollars?

Mr. HACKETT. It is not the very small business owner, the man with the small retail store, to whom I refer. It is the man in the middle group. He has built up a business, probably from a small beginning, to a point where it is worth $100,000 or $150,000 at the time of his death.

Mr. SCOLL. It would have to be higher than that.

Mr. HACKETT. It may be "worth" only that amount—and that is my point: It may be worth that amount on a liquidating basis, but for tax purposes it may be held by the taxing authorities to be worth a great deal more.

Mr. SCOLL. If it is worth anything up to $250,000 under the existing law, and with the splitting provision, the tax is not too burdensome.

Mr. HACKETT. The splitting provision, Mr. Scoll, as you know, is not a reduction of tax, it is a deferment of tax. It may reduce the tax at the death of the first spouse to die, but the evil day then comes when the surviving spouse dies. The total tax that will be levied at the deaths of both spouses can be approximately the same under the new law as under the old.

Mr. SCOLL. My point is that on estates of $250,000 or under the dollar amount of tax is not too great.

Mr. HACKETT. True, at the death of the first spouse; but at the death of the second you pick a second tax up, and the total tax payable at both deaths will be just the same as under the prior law. In some cases it may be heavier than under the prior law.

Mr. KREPS. If I may indicate the type of summary that your evidence shows to me at any rate: The fair market value basis, the way in which we normally value assets, is objectionable from your point of view in that it in essence gives the Treasury Department a bargaining leverage and enables them to start from too high a point. And you feel that some formula should be derived whereby that bargaining leverage would be reduced a bit.

Mr. HACKETT. That summarizes it.

Mr. KREPS. Yes.

Mr. HACKETT. Does that cover the question?

Mr. KREPS. Yes, thank you.

Mr. SCOLL. You have some further points, have you not?

Mr. HACKETT. That is right.

Mr. SCOLL. Why do you not go ahead with those?

Mr. HACKETT. As stated before, these controversies are time-consuming—this introduces an element of added cost, although it is not tax cost—in terms of counsel fees and other charges, whether the taxpayer wins or loses his claim. I should like to also submit a short, but representative list of court cases which involved claims of tax value, showing the time required to settle them.

(Chart B is as follows:)

CHART B

Title of case	Time from death until value established		
	Years	Months	Days
Hanscom, Exrs., 23 BTA 173	5	1	19
Estate of McDougall, 45 BTA 803	2	11	27
Brooks v. *Willcuts*, 9 F. Supp. 19	4	6	11
Estate of Bennie, 13 BTA 105	4	9	16
R. S. Buchanan, TC Memo, 2-8-41	4	8	2
National Bank of Oneonta, 17 BTA 654	7	2	15
Waterman, J. B., BTA Memo, 12-12-41	4	7	12
Walter, H. H., Exrs., 2 BTA 453	2	9	27
Estate of H. M. Springer, 45 BTA 561	4	7	26
Johnston, H. L., TC Memo, 6-22-43	5	5	1
Hazelton, B. F., Jr., TC Memo, 7-14-43	3	5	11
McIlhenny, F. P., 22 BTA 1093	5	4	16
E. M. Staunton Estate, 29 BTA 376	7	10	1
Estate of Geo. H. Walker, 23 BTA 663	6	8	13
True, Exrs., v. *U. S.*, 51 F. Supp. 720	2	9	15
Burda, L. J., TC Memo, 7-21-43	1	6	7
Bank of California, 133 F. (2d) 428	6	9	15
Edwards, C. W. Exrs., 31 BTA 879	5	6	17
Kennedy, Exrs., 4 BTA 330	2	11	18
Estate of W. Maxwell, TC Memo, 11-3-44	5	3	7
G. F. Milton, 17 BTA 380	5	4	28
Bob v. *Commissioner*, TC Memo, 6-7-45	4	3	21
Vandenhoeck, Estate of P. M., 4 TC 125	5	6	9
Anthracite Trust Co., Admr., 3 BTA 486	2	10	8
Average period of time from date of death to date of court's decision	4	8	9
Shortest period: Burda, L. J., TC Memo, 7-21-43	1	6	7
Longest period required: *E. M. Staunton Estate*, 29 BTA 376	7	10	1

Mr. HACKETT. In this list of 24 cases, 23 of them are reported on the earlier table, chart (a), and you can determine from the first table how they were finally settled, whether in favor of or against the taxpayer.

I have summarized them, although my figures do not appear on your copies.

You will note that the average period of time from date of death until the Tax Court's decision, when the value was finally determined, was 4 years and 8 months and a few days.

The shortest period of time is almost a year and a half and the longest period of time is 7 years and 10 months.

But even when these decisions were finally arrived at, 10 of them were decided—out of 25 separate disputed values—in favor of the Commissioner's claim, which was the highest value claimed; 11 were compromises, which were necessarily higher than the taxpayers' claim; and only 4 were settled in favor of the taxpayer.

Again your percentage is against the taxpayer, even after resorting to the courts.

So far we have dealt in generalities. I should like now to draw upon my own experience and show you gentlemen exactly how this problem applies to specific cases. I believe that I can show you that this is an important factor affecting the investment of private capital in closely held businesses.

I shall take for illustration a group of 20 individuals. These are the last 20 cases, consecutive cases, that I have analyzed. They are not hand picked; they are, as I say, my last 20 cases, taken in order. These analyses were made between April 1948 and November 1949; so they are current.

Mr. Scoll. The new 1948 tax provisions, of course, apply.

Mr. Hackett. Yes. The nature of these estates, the proportion of them involve closely held business interests, and the problems inherent in them, I can assure you, are representative of the entire group of 400 to 500 estates that I have analyzed.

The following table, then, shows a condensation and simplification of the type of assets and tax factors involved in these 20 estates:

(Chart C is as follows:)

Chart C.—*Composition of 20 estates*

	(1)	(2)	(3)		(4)	
Case No.	Liquid marketable assets	Semiliquid assets	Close corporation, partnership, and proprietorship investments		Total estate	Estimated succession taxes
			Book value	Estimated tax value		
2010	$236, 150	$352, 000	$859, 900	$960, 030	(A) $1, 548, 180 (B) 1, 448, 050	$617, 624
2011	176, 110	244, 957	50, 000	50, 000	421, 067	134, 953
2012	129, 400	120, 000	138, 116	470, 116	(A) 719, 516 (B) 387, 516	162, 992
2013	121, 050	81, 896	29, 600	155, 580	(A) 358, 526 (B) 232, 546	64, 183
2014	59, 811	141, 817	381, 117	440, 166	(A) 641, 794 (B) 582, 745	296, 904
2015	398, 000	262, 970	----------	----------	660, 970	230, 236
2016	77, 457	95, 600	91, 760	189, 131	(A) 362, 088 (B) 264, 717	138, 227
2017	276, 050	127, 948	221, 973	338, 095	(A) 742, 093 (B) 625, 971	190, 539
2018	45, 692	146, 332	330, 950	587, 224	(A) 779, 248 (B) 522, 974	236, 829
2019	108, 679	15, 000	452, 938	867, 158	(A) 990, 837 (B) 576, 617	320, 763
2020	213, 000	60, 000	----------	----------	273, 000	79, 647
2021	90, 000	45, 000	----------	----------	135, 000	21, 435
2022	18, 625	53, 190	45, 510	138, 987	(A) 210, 802 (B) 117, 325	50, 109
2023	500, 265	365, 000	32, 883	32, 883	898, 148	295, 785
2024	29, 150	157, 695	158, 755	363, 710	(A) 550, 215 (B) 345, 600	107, 019
2025	14, 180	98, 640	68, 736	268, 736	(A) 381, 556 (B) 181, 556	95, 792
2026	151, 243	91, 000	8, 645	8, 645	250, 888	70, 094
2027	24, 000	35, 200	158, 755	363, 710	(A) 422, 910 (B) 217, 955	66, 609
2028	142, 744	41, 000	36, 090	123, 909	(A) 307, 653 (B) 219, 834	95, 683
2029	87, 654	12, 000	41, 160	141, 316	(A) 240, 970 (B) 140, 814	52, 751
Total	2, 899, 260	2, 547, 245	3, 106, 888	5, 499, 396	(A) 10, 945, 901 (B) 8, 553, 393	3, 328, 174

Mr. Hackett. By way of explanation, the first column is merely a grouping of all the liquid assets—cash, securities and bonds—in one figure.

The second column is life insurance and annuity contracts that are payable to named beneficiaries, real estate, tangible personal property—the type of property that is not readily reduced to cash or available to pay taxes.

Under (3) there are two subcolumns, one showing the book value of the close corporation business interests, wherever they are involved; the other showing the maximum estimated tax value that might be claimed if the Department were to capitalize 3 years' average earnings at 10 percent, which is an arbitrary basis, but one that is fairly close to the average figure that they use. So from these figures you get an idea of the spread between the two values.

The fourth column shows the total value of the estate totaled two ways: (A) If the higher value is sustained for the close corporation interest, and (B) the lower value that would result if the taxpayers' claimed value stands up.

And in the last column is the total estimated succession taxes that will be levied on these properties after the death of both the taxpayer and his wife, by the time the properties reach their children.

If I may, I would like to briefly go through these cases and show you case by case what would happen. These cases, of course, have not been administered. These are the findings of the analyses that were made to show the individuals the post mortem status of their estate.

As you can see, 16 of these 20 have investments in closely held businesses. In the case of 11 of these 16, the dollar value of their investments in their businesses (taken on a basis of book value) represents 30 percent or more of their total wealth.

I should now like to briefly review each of these cases and point up the problem of tax valuation and its consequences, as it applies to each:

No. 2011: Is a man 70 years of age. He operates a business that he built up during his lifetime. He is a widower, and has two children, a son and a daughter. His son is associated with him in his business. The company is owned by the father and two children: he owning 27 percent; his son 37 percent; and his daughter 36 percent.

If this company's past 3 years' average earnings were capitalized at, let us say, 10 percent, the resulting value would be approximately 11½ percent higher than book value. This is not too serious. On this basis of value, at his death, succession taxes will aggregate $259,360, and there would be $236,150 of cash and listed securities, and $15,000 of insurance payable in cash, available to pay these costs. Accordingly, his estate would be solvent.

At his son's subsequent death, however, succession costs would aggregate $193,199 (assuming present property values and tax rates prevail), and at his daughter's subsequent death her succession taxes would amount to $165,065.

Inasmuch as the children have no liquid assets now, and would have inherited no liquid assets from their father, unless they could each accumulate enough liquidity before their estates were administered, and despite high personal income tax rates, or convert the semiliquid assets they would have inherited into cash, part or all of their close corporation stock would have to be sold, or the company liquidated. As you know, it is difficult to find a buyer for a minority interest in a family-owned close corporation.

Mr. SCOLL. Excuse me a moment. Is that the same as case 2011 on your chart C?

Mr. HACKETT. Yes, sir; it should be the same.

Mr. SCOLL. The figures do not seem to gee. You put in there estate succession taxes will aggregate $259,360.

Mr. HACKETT. That is right.

Mr. SCOLL. How do you get that out of the figures you have on chart C?

Mr. HACKETT. That is the tax at the father's death, $259,360; and the tax at the son's death is $193,199; and the estimated tax at the daughter's death would be $165,065.

Mr. KREPS. This is case 2010, is it not, rather than 2011? Is there not a misprint?

Mr. HACKETT. Yes, there is a typographical error, Mr. Scoll. I am sorry.

Mr. KREPS. When you say "subsequent," you do not mean to imply that the son is going to die the next day?

Mr. HACKETT. No; we are assuming his death at any time after his father's.

Mr. KREPS. You mean a generation later.

Mr. HACKETT. A generation later. And we have to also assume that there will be no change in property values or tax rates.

Mr. KREPS. You mean over a generation?

Mr. HACKETT. Right.

Mr. KREPS. And you assume no chance to acquire liquid assets over a generation?

Mr. HACKETT. There will, of course, be some chance to acquire liquid assets, but I would like to point out that in these 20 cases, these people have been over a generation acquiring their liquid assets—and some of them under more lenient and lower income tax laws—yet as a group they have been able to only acquire, on the base of total values shown here, less than a third of their total net worth in liquid form.

And if we may speculate, it does not seem that in the future the average individual will have an opportunity to acquire very much more than that percentage, if as much, in liquid form, over the period of his lifetime, unless we should have a substantial lowering of income tax rates.

Mr. KREPS. Although it appears even at the present time the son owns already 37 percent of the business and the daughter 36 percent.

Mr. HACKETT. Right. Those interests were given to them by the father.

Mr. SCOLL. Where the incidence of the various estate taxes on this property are separated by periods of years, as much as a generation, do you really think it is a proper assumption there would be no change in the amount of available property or value through growth which would be reflected in income or property values to pay another estate tax?

Mr. HACKETT. On the basis of past experience, Mr. Scoll, there will be an opportunity to acquire some amount of liquidity outside of their interests in this business. But although the estate tax rates start at 3 percent today, it does not take very much property to get up to the 30-percent bracket. That means that each succeeding generation is going to have to acquire at least 30 percent of their wealth in liquid form in order to meet the taxes when they pass on.

The past history of all the cases that I have worked on has indicated to me that it is very difficult for a man during his lifetime to acquire more than 30 percent in liquid form out of the operation of a small close corporation.

Mr. KREPS. I trust you are quite aware of the fact that liquid savings in the last years of business, net business savings, have gone up from a figure of $495,000,000 to $11,072,000,000. There never has been a period in which the net liquid savings of businesses and of individuals have increased more rapidly than precisely this period that you mention.

Mr. HACKETT. I am aware of it.

Mr. KREPS. And I am interested as an economist that in the face of such facts you should be willing to forecast for an entire generation that the chances of making liquid savings are likely not to increase.

Mr. HACKETT. I am not willing or attempting to forecast. I will say this, though, if I may refer to your statement: while it is true that savings have gone up, by the same token the tax values of these businesses that we are talking about have also gone up, meaning that the tax levies that will eventually accrue have also gone up.

Mr. KREPS. You mean by the same amount?

Mr. HACKETT. Not necessarily, that does not follow. But the fact that people have been enabled out of small businesses to make more money than ever before has also increased the value of their businesses for tax purposes.

Mr. KREPS. Personal savings have also increased in this period. Gross personal savings have increased from 2,888 million dollars to 12,220 million dollars, and again in this very period of high war taxes and State taxes and the like.

Mr. HACKETT. That is true.

I do not say this with authority, but I put it as a question. Is it not true a good part of those savings have been accumulated by a class of people that we are not considering here?

Mr. KREPS. I would say—again I have the figures—that the businesses that have thrived mostly have precisely been what we call "entrepreneur withdrawals." It is the unincorporated business, in general the small business—at least until 1948.

Mr. HACKETT. That is no doubt true, but the individuals who own them and are receiving income from them have not been in the group who have been able to acquire in liquid form the greatest proportion of this increase in savings. They have been subjected to the higher brackets of income tax and, therefore, have saved less proportionately than a man who is working in a shop at a high wage and who is getting more money than he ever made before.

Mr. KREPS. The Federal Reserve Board studies just published also indicate these savings by and large—and when I say "by and large" I mean 85 percent—are made by people in income brackets over $6,000. It has been the group between 6,000 and 25,000 to 35,000 that have made the largest savings. It is only when you get beyond 50,000 a year that the tax take becomes a predominant factor.

Mr. HACKETT. Well, the group we are talking about here would fall pretty well within the brackets you outline. I mean that they are people who as a group are getting about twenty-five to thirty thousands dollars a year.

Mr. KREPS. I realize that.

Mr. HACKETT. It may very well be—and of course I have no way of knowing—that in going back to my table (c) and looking at the liquid portions of these estates a great portion of it may have been accumulated in the last 4 or 5 years. And, assuming that these people can continue at this rate, they will accumulate more in liquid form. But if their businesses continue to produce high earnings, they will also, no doubt, plow back into their businesses the maximum amount that they can, and they are still going to run into this same problem of increasing the value of the goose that lays the golden eggs for them, which leads up to a still more serious tax problem at the time of death

Mr. KREPS. I am merely posing the question, of course.

Mr. HACKETT. I understand. And I am trying to explain, that although I cannot forecast, I think the same factor that enables them to save wealth in liquid form will also raise the value of the property which is producing their savings and eventually result in a serious valuation and related tax problem at death.

Mr. KREPS. I think I understand how you look at the problem.

The CHAIRMAN. Of course there is bound to be a tax problem at death.

Mr. HACKETT. That is true.

The CHAIRMAN. Until we have settled the problems of peace and paid a substantial part of the war costs.

I am wondering, however, as I listen to your testimony, whether your case would not be stronger if you rested it solely upon the estimate of the tax to be paid by the father instead of adding to that an estimate of the tax to be paid subsequently by the son, and subsequently by the daughter. These figures that you give for the son and the daughter are necessarily based upon, as you state, exactly the same assumptions as in the case of the father.

Mr. HACKETT. Yes.

The CHAIRMAN. And that is an impossible assumption, it seems to me, unless you assume that the death of all three will take place under exactly the same conditions. And that, I think, you cannot do.

Mr. HACKETT. If you will bear with me, Mr. Chairman, you are absolutely right. However, as I say, I took these cases consecutively. This is the only one involving a father and two children. The others are all cases of husbands and wives who are of approximately the same age, and you can in those cases reasonably expect that within some relatively short period of time of each other the two estates will be administered.

And I think they will further prove up my point.

Then there are other cases involved where I can point out the effect of the tax impact upon the death of one person.

The CHAIRMAN. It may be relevant at this point to ask you about your statement at the beginning, the significance of your statement at the top of page 2, with reference to—

> post-1932 wealth has largely been created by the development and operation of small closely held corporations, partnerships, and proprietorships.

The use of that phrase "post-1932 wealth" assumes the creation of wealth after the depression of 1929; does it not?

Mr. HACKETT. That is right. The "post-1932" reference is made for two reasons: First, my experience starts at approximately that time; and second, there were a great many people, as we all know, who prior to 1929 had made their wealth in the stock market, speculating. I have no way of knowing what the figures would have been on the average person at that time, prior to 1932. I was not engaged in tax work at that time but I am inclined to think that we would have had an entirely different picture of our over-all economy and the sources of wealth had we gone into the twenties for data. I had some slight experience with financial matters during the twenties although I was just out of school and in the security business. It seemed to me at that time that most people were trying to make money by picking the right stock and riding it for a short period of time and then taking their profit.

The CHAIRMAN. But it is your experience during your active period as estate counselor that a substantial amount of post-1932 wealth has been created?

Mr. HACKETT. That is true, and it has been created largely in the form of investments in middle-class businesses.

The CHAIRMAN. Well, that means substantially small business; does it not?

Mr. HACKETT. That is right.

The CHAIRMAN. And local business?

Mr. HACKETT. That is right.

The CHAIRMAN. So that except for the onerous character of wartime taxes; your experience presents a rather encouraging picture?

Mr. HACKETT. That is true.

The CHAIRMAN. In the creation of wealth?

Mr. HACKETT. That is true. We really started with a clean slate, if we could call it that, about 1932. We had wiped out, or were starting to wipe out, the excesses and false values of the twenties and starting with a new basis.

The CHAIRMAN. It has always seemed to me that every discussion of tax problems and Government spending ought to be based clearly upon the known fact that because of the depression, and because of the war, the burden of Government necessarily became very much greater, and the Government could not perform its functions except by obtaining revenue in one form or another. That revenue had to be derived either by taxation or by what we call deficit spending, meaning the issuance of bonds primarily. So that when we discuss these problems we cannot divorce them from the fundamental point that Government has had no alternative in the depression, in the war, and in the postwar period, but to undertake the expensive programs that are necessary to preserve the very basis of society.

Mr. HACKETT. I concede that. I am not an expert on Government financing, but my reaction to present Government spending is perhaps typical.

While it is conceded that none of us would want to do away with the necessary expenditures of Government for necessary services, for armaments, for the things that are vital to us as a country, I think we taxpayers do wonder, though, sometimes why the Government cannot, as an individual often has to do, more efficiently spend the money that they have to spend. Individually we all perhaps have encountered lean years in which we had to cut back our standard of living and personal expenditures, even though we thought at the time that we could not do it, in order to meet our bills and our obligations. And I think that the average person, certainly those that I deal with, wonders why Government cannot, as an individual or small business many times has to do, curtail their expenditures by efficiently spending the money that they have to spend.

The CHAIRMAN. Well there again there is an assumption that for some reason or another Government does not efficiently spend the money that it has to spend.

I have been very much impressed by the fact that the newspapers of the country and commentators are discussing the reorganization of the executive branch of the Government as recommended by the Hoover Commission as though that recommendation was a perfectly definite, explicit plan for the efficient expenditure of money.

It is completely overlooked that the reports are full of dissents.

Take the case of the Hoover Commission report on reorganization of the Interior Department. I am interested in that particularly because I happen to be chairman of the Senate Committee on Interior and Insular Affairs.

Now that document presented to Congress contains a majority report, from which several members of the majority, including Mr. Hoover and the late Secretary Forrestal, recorded variations of opinion—not very serious, but there was a variance.

Then there was a minority report, and then there was a third report by two other members of the Commission.

So that nobody, whether he is a member of the Hoover Commission or not, at this moment can tell what plan of reorganization could possibly come out of that recommendation, nor what savings could be effected.

Then there was the report on the Department of Agriculture. The Department of Agriculture is one of the largest departments we have, and the appropriation for the Department of Agriculture annually has been running at a very substantial sum; over a billion dollars.

The Hoover Commission report recommends a saving of $82,000,000. It is not going to reduce taxes at all appreciably, it would seem to me. And so it goes. The assumption that there is gross waste is not supported by specific figures.

I will agree anytime that there is waste in national defense. War itself is waste. And the operation of the Army and the Navy and the Air Force naturally calls for expenditure, I would think, judging from what I have seen, on an inefficient manner. But every effort is made by Government to bring in the best brains that can be found to manage the national defense.

Some people have even criticized the attitude or the policy of Government in that respect by charging that some of the people who were brought in were from big-business interests and were more interested in serving their interests than they were in the efficient expenditure of public money. I do not say there is any basis for that charge; I just say it has been made from time to time. Personally I do not think there is. I think that when men have been recruited from the field of business to assist in the Government they have given their very best. And it is notable, I think, that in the case of national defense the present Secretary, Mr. Louis Johnson, has been doing his very best to cut expenditures and to carry out the recommendations, couched in generalities, of the Hoover Commission. And he has been having a very tough time doing it.

You may proceed.

Mr. HACKETT. Case No. 2011 on my chart (c) is the case of a California man whose business interest consists of a proprietorship, worth $50,000; a manufacturers agency. Inasmuch as it is a one-man business and its assets consist mainly of cash and unpaid commissions, it would and could be liquidated easily at his death, as he has provided in his will shall be done. Our problem does not, therefore, arise in this case.

No. 2012 is another Californian, 79 years of age. He has a substantial interest in an automobile agency whose stock has a book value of $48 per share and a capitalized earnings value—average earnings for past 3 years, capitalized at 10 percent—of $183.30. Total succession costs that would be levied at his death and at his wife's subsequent death would aggregate $162,992. This would more than consume their $129,400 of liquid marketable assets. Unless other of his properties, such as real estate, could be sold, part or all of his business interest would therefore have to be disposed of. As in the first case, this family is also faced with the necessity of eventually disposing of their business.

No. 2013 is an inventor, a resident of New York. He has a corporation the sole assets of which are a number of patents, some under short-term licenses, which cost him $29,600 to develop. A capitalization of the income of this corporation, figured on the basis of the remaining years his patents have to run, would give the business a value of $155,580. Transfer costs at his death would then amount to $34,662, and at his wife's subsequent death $29,521, a total of $64,183. There is $121,050 of cash and listed securities in his estate with which to meet these costs. However, if they are used to pay taxes, the remaining assets in his estate will consist largely of an interest in a close corporation having a doubtful earning power. As a consequence, he would like to sell the business during his lifetime, but unfortnuately the only potential purchaser is one large corporation which is only willing to buy on their own terms and at their own price. He is not willing to sell now and therefore has provided in his will that the business be sold at his death.

No. 2014 is a New York real-estate man. He is 65 years of age and his wife is 61. They have one son, who is associated with his father in the business.

The wealth of this family has been accumulated in the form of income-producing real estate. Four corporations hold these properties, and they have a combined appraised value of $381,117. Applying the capitalization of earnings basis to these companies gives a total value of $440,166—which is not too much higher than their liquidating value.

However, the total succession costs that will be levied at the death of this man and his wife will aggregate $269,904, and their estates contain but $59,811 of liquidity. Therefore, this family, too, must eventually sell or liquidate part or all of their businesses.

No. 2015 is that of a man, an Ohioan, who sold out his close corporation business interest several years ago, primarily because he knew that a forced sale would be required when his estate was administered. The purchaser was one of his larger competitors, who used wartime profits to make the purchase.

This man has invested the proceeds of the sale of his business largely in Government bonds, and blue chip stocks. It would be difficult, if not impossible, to prevail upon him to invest in a small closely held business again.

No. 2016 is a man who has built up a prosperous automobile agency in Ohio. As you can see, a relatively small proportion—$77,457—of his total wealth is in liquid marketable assets. Personal income taxes are largely responsible for this.

The book value of his business is $91,760, but using a capitalization of earnings basis the value mounts to $189,131—more than twice as much.

Succession taxes payable by the time his properties and his wife's reach their son, who is active in the business, will aggregate $138,227. Because the estate does not contain sufficient liquidity to meet these payments this man has arranged that his business be liquidated at his death, at whatever it will bring at that time.

No. 2017 is that of a client of mine who owns a prosperous retail jewelry store and a mill. Up until several years ago he had three mills, but two of them burned and he decided not to replace them, one of the principal reasons for this decision being his awareness of the problems that beset a decedent's estate, if it holds close corporation equities.

The two companies he now owns have a total book value of $221,973. Capitalizing their earnings gives a value of $338,095, which is more than 50 percent higher than book.

Succession taxes on his estate and his wife's would aggregate $190,539. The estate contains $276,050 of liquid marketable assets, so that payment of taxes would pose no serious problem—other than to deplete the most liquid portion of his estate. This man, however, has made provision in his will to the effect that both businesses be sold or liquidated at his death, as he wants to conserve the liquid portion of his estate for his heirs.

No. 2018 is an Ohio manufacturer of gloves. He is 46 years old and has built up two small, profitable, manufacturing businesses through his own efforts. These companies have a combined book value of $330,950, but by capitalizing earnings the tax value could be boosted to $587,224. Taxed on this basis, his estate and his wife's would be required to pay a total of $236,829 in succession taxes, by the time their properties reach their two children. Obviously, the $45,692 of liquid assets they have been able to accumulate would not go far toward meeting these costs. Therefore, some parts of their close corporation holdings must eventually be sold. Again, I point out that a sale of a minority interest in this type of business would probably not be feasible. Query: What will happen to these two businesses when this man dies? Who will buy them and what will his estate realize on his lifetime's work?

No. 2019 is a man 78 years of age, a widower with one married daughter, and three grandchildren. He lives in a small town near Columbus and has acquired, as you can see, a substantial estate—having made most of it before income taxes reached their present high level. He owns a cannery, a wholesale grocery company, and two corporations which operate farm properties. Using present market values for the farm properties, and book value for the cannery and wholesale firm, his interests in these corporations are worth $452,938. But, if earnings are capitalized, the resulting value is $867,158—almost double the book value.

Taxes at his death—using the higher value for his businesses—would amount to $320,763. To pay them, his estate contains but $108,679 of liquidity, with the result that some part or all of his businesses will have to be sold. He is now trying to sell his close corporation holdings, if he can find a buyer.

No. 2020 is one that does not involve this problem, as this man sold out his business interest several years ago, to a competitor, and put the proceeds largely in Government bonds.

No. 2021 likewise does not encounter this problem, as this man holds a salaried position.

No. 2022 is the case of a man who has built up two small local businesses which operate vending machines in Ohio. One is a corporation all of whose stock he owns, the other is a partnership in which he has a 25-percent interest. If his estate were to retain these two businesses after his death, and as a consequence they were valued on a capitalized earnings basis, they would be valued for tax purposes at $138,987, which is better than three times their present book value of $45,510.

It is interesting to note in this case that because the top Federal estate tax rate at which this man's properties would be taxed is 30 percent, if the capitalized earnings value were established for tax purposes, the tax on these holdings would amount to $41,696, which is almost equivalent to their present book, and presumably liquidating value.

In any event, there would be but $18,625 of liquid assets with which to meet succession costs totaling $50,109 by the time his properties reach his children. Thus, unless he can build up liquid holdings at a rate faster than he has been able to so far, his business interests will eventually have to be sold at his death.

No. 2023 is the estate of a man who sold out his local department store several years ago to a large national chain. Taxes were his prime reason for making the sale. Presently he holds principally Government bonds and the listed stock of the purchasing corporation, which he received as a part of the purchase price.

Nos. 2024 and 2027 are a father and son who, with $5,000 of capital, started out in 1930 and built up a chain of small-town dry goods stores. They have also acquired a dairy farm, a dairy, and a retail dairy products store. These properties are held in the form of two corporations owned in equal shares by the two of them. The interests of each of the two owners are worth $158,755 on a basis of book value, or $363,710 on a capitalized earnings basis.

The deaths of the son and his wife would require payment of $107,019 in succession taxes, and their estates contain but $14,180 in liquidity. In the father's case, the administration of his estate and his wife's will require payment of $66,609 in succession costs, and they have but $24,000 in liquid marketable form.

Therefore, upon the death of either the son or the father, or both, some part or all of the decedent's interests will have to be sold or liquidated. Not knowing when this sale will have to be made, or what conditions will be like at the time, it is hard to foresee what the outcome will be. I think it is safe to state, however, that the present owners are very apt to come out second best.

No. 2025 is another case where, starting 5 years ago in the automobile business, a young fellow has built up a small corporation to a present net worth of $68,736. He has not been able to accumulate—as you can see—much of any other type of property, due to high personal income tax rates.

If his death were to occur today and a capitalized earnings value was upheld as the tax value of his business, it would result in a value of $268,736. On this basis, succession taxes of $95,792 would be levied by the time he and his wife are both gone and since his liquidity only amounts to $14,180, there would be no alternative other than a sale or liquidation of the business.

No. 2026 is the case of a man who has the bulk of his estate in Government bonds and cash, and a small investment in debenture bonds of a close corporation. The valuation problem therefore would not arise in his case.

No. 2028 is a small-town banker. As an investment he holds a substantial block of stock, a minority interest, in a local manufacturing company. The only market for these shares is the family who owns the company and they have been currently buying small odd lots at $30 per share. The book value of the stock, however, is $103 and a capitalization of earnings gives a value of $96 per share.

Another one of the larger minority stockholders recently died and his shares were appraised for tax purposes at book value, $103 per share, with no attention paid to the lower local market price of $30 per share.

In this case, if my banker client dies and his shares are appraised at book value they will be included in his estate at a total figure of $123,909, even though they will bring only $36,090 if sold on the local market.

On this basis his estate, upon which the top estate tax bracket will levy 30 percent, will have to pay $37,173 in taxes on these shares, if they are assessed at the higher value. Yet the stock can only be sold for $36,090.

Obviously, the best thing he can do with this stock is to get rid of it before his death.

No. 2029 is similar to the banker's case. In fact, it is the estate of a cousin of his who also has a substantial minority holding in the same company.

In her case the local market value of her shares amounts to $41,160, while their book value is $141,316. If at her death they are taxed at the higher value, her estate will pay approximately $45,221 in taxes on these shares; yet they will bring no more than $41,160 in the local market. Thus, if her estate holds the shares at her death, and does not sell them afterward, the tax thereon will amount to 110 percent of the price at which they can now be sold. She too, obviously, cannot afford to hold this investment.

This then, gentlemen, is a cross-sectional view of a small but representative group of those people who constitute an important part of our economy. Would you, in light of these facts, invest any substantial amount in a closely held business?

We all know that the continued success of this country is directly dependent upon maintaining a high level of production and steadily increasing it. Too, I believe that we must look to the smaller business, and encourage it—but not necessarily pamper it—if we are to obtain that objective—and save our economic life in the process.

On the other hand, my experience leads me to believe that our present high estate and inheritance tax levies are slowly but surely destroying the small business. Their effect is less noticeable than, for instance, an increase in corporate income taxes, because they do not affect all property owners at one time; they pick them off one by one, so to speak, as the keymen owners die. It is now proposed that estate tax rates be further increased; and if they are, they will still not produce a very substantial amount of revenue. In fact, if the Government had levied a 100 percent tax on the estates that they collected from last year, the revenue so received would still not have been a significant amount, in light of the Government's needs. I wonder, though, how many small closely held businesses were sold, liquidated, or otherwise destroyed last year because of the combination of high estate tax rates coupled with arbitrarily high claims as to their tax value.

Thank you, gentlemen.

Mr. Scoll. Mr. Hackett, most of your cases appear to be cited and explained in support of the general position that the taxes on these estates are too high. That is roughly what it amounts to?

Mr. Hackett. That is true.

Mr. Scoll. So that in your approach to the level of the tax, it is through the valuation channel rather than the rate chanel. Is that what it amounts to?

Mr. Hackett. The method of valuation is certainly one factor that aggravates—if I may put it that way—the tax impact. Some of these cases even without that aggravation would still have a serious tax problem.

Mr. Scoll. Another kind of tax problem such as the liquidity problem?

Mr. Hackett. That is right.

Mr. Scoll. Or some other form of estate tax problem?

Mr. Hackett. That is right.

You made the statement a short while ago, which I answered in part, that the individual could during his lifetime, by gifts or insurance or other means, minimize his taxes and provide for their payment.

I attempted to answer the statement regarding gifts—that many individuals, while they can so minimize taxes, do not choose to do so.

As to taking out insurance as a means of providing liquidity, it being taxable, as it is nowadays if owned by the individual and the premiums are paid on it by him, you get into a spiraling upward of taxes, in that the more insurance you buy, the higher your tax bracket is. A part of the insurance itself must always go for taxes; and therefore, the more insurance you have, the more your taxes will be.

Mr. Scoll. That is if the insurance is carried by the beneficiary of the insurance, the taxpayer.

Mr. Hackett. If the insured, who is also the owner, is the taxpayer.

Mr. Scoll. But it is not necessary that the insurance be carried in that form.

Mr. Hackett. Frankly, there are relatively few men who are so situated that other members of their family are in a position to carry insurance on their lives. In most cases other members of the family do not have sufficient income with which to carry insurance on the life of another. The only way insurance can successfully, as you know, be kept out of an insured's estate is if some other member of the family has an independent income which is used to pay premiums on insurance on his life.

Mr. SCOLL. There, again, in the case of a family business it is a question of, perhaps, distribution of ownership and income from the family property and the family corporation to other members of the family.

Mr. HACKETT. Along that line, may I point out, Mr. Scoll, that we have just gone through a long siege of tax disputes, not in the case of closely held corporations, but in the case of family partnerships, where attempts have been made to put into the hands of their families some portion of their earnings by giving them an interest in a partnership. And in every case the Internal Revenue Department held that such a gift of a partnership was not a bona fide gift to the extent that the income therefrom would be taxed to the individual partners. It was all taxed to the head of the family if he was the principal operator of the partnership.

Mr. SCOLL. If no services are performed by the other partners.

Mr. HACKETT. That is right; that has recently been decided. But there was a long period of time when they were jumping all family partnerships regardless of services or contribution of the members.

Mr. SCOLL. But that problem has been somewhat clarified.

Mr. HACKETT. That has been somewhat resolved at the moment.

Mr. SCOLL. What we are getting at here, we are trying to find out how we can further solve some of these problems within the framework of the existing code and the regulations, perhaps, by proposing some amendments, bearing in mind, as the Senator points out, that we still have the over-all revenue problem which cannot be escaped regardless of the fact that estate-tax revenues are small.

I want the record to show, as you admitted, in at least cases of family partnerships some progress is being made toward the clarification of that problem.

Mr. HACKETT. Yes, but there are several of these cases that I have submitted, and as you have noted, where men have sold out their interests in a small business to large corporations, which is usually their sole market, during their lifetimes for one of two reasons—either to escape the problem that they know will arise eventually, the question of a forced sale at death; or, because in certain of the cases the price offered was attractive enough.

The CHAIRMAN. Is there not another reason for that occasionally having nothing to do with taxes—namely, that the owner of the business looking over his family finds no managerial successor?

Mr. HACKETT. That is a factor in certain cases, Mr. Chairman.

I think that reason for selling is the exception, though. They usually all have either built up within their families or within their own organization successors to management.

But the only point I am trying to make is that the flow of equity capital there is away from the smaller business when a man sells out and usually into the larger so-called blue-chip companies.

The CHAIRMAN. That is right; there is no doubt about it.

So that prompts me to make this remark, perhaps, in the form of a question which you can develop as you choose when you come to it.

Inasmuch as the purpose of this inquiry is to find ways and means of encouraging the access of small business, local business, independent competitive business, to the reservoir of savings for the purpose of operating and expanding business, does it not appear that the inheritance-tax law as a whole, which seems to take, from your chart C, a very substantial part of the liquid marketable assets in each of these cases, operates in exactly the opposite direction from that which we are attempting to go?

Mr. HACKETT. Yes, it does, Mr. Chairman. As I see it, your inquiry should be directed to two things: one, not only as to how to encourage equity capital to seek investment in small businesses but, secondly, how to prevent equity capital from being forced out of small businesses.

The CHAIRMAN. To keep it there after it is in.

Mr. HACKETT. To keep it invested in small business.

The CHAIRMAN. Now, your column on chart C of estimated succession taxes totals $3,328,174. If it were modified to accord with the criticism we have made of case No. 2010—that is to say, to eliminate the estimated succession tax to accrue at the time of the son's death, and then at the time of the daughter's death—that total would be considerably less; or not?

Mr. HACKETT. It would probably be not considerably less. But, if I may hazard a guess, it might be as much as 20 percent less than that figure.

But I can tell you this: That if the Government loses revenue in the form of estate taxes, will they not gain it, if the small business continues, in the form of income taxes?

The CHAIRMAN. I am inclined to believe that is the case.

Mr. HACKETT. The Government has a stake of 38 percent in the earnings of small close corporations.

The CHAIRMAN. Well, for the purpose of this inquiry, suppose you make a computation of that estimated succession tax upon the basis that I have just suggested, without these forecasts of future taxes on those to whom the succession comes. You might include, of course, where the husband and wife are about the same age.

Mr. HACKETT. I shall be glad to do so.

The CHAIRMAN. Where they are about the same age and that sort of thing.

Mr. HACKETT. Right.

The CHAIRMAN. On that basis, whatever you choose to put in that figure, so we may compare your total estimated tax with your total liquid asests.

Mr. HACKETT. Right. I will be very happy to do that and I will do it in each individual case that involves husband and wife.

If you would like, I can also try to carry my figures a step further and show what succession taxes would be if a formula value for the business interests were accepted for tax purposes.

The CHAIRMAN. Suppose you do.

Mr. SCOLL. Or do it on the basis of actual values given and set forth in your chart.

Mr. HACKETT. I will use the same values but with new tax computations.

Mr. SCOLL. All right.

(The information referred to follows:)

Chart C.—*Composition of 20 estates (adjusted)*

	(1) Liquid marketable assets	(2) Semiliquid assets	(3) Close corporation, partnership, and proprietorship investments		(4) Total estate	Estimated succession taxes
			Book value	Estimated tax value		
Case No.—						
2010	$236, 150	$352, 000	$859, 900	$960, 030	A $1, 548, 180 B 1, 448, 050	$259, 360
2011	176, 110	244, 957	50, 000	50, 000	421, 067	134, 953
2012	129, 400	120, 000	138, 116	470, 116	A 719, 516 B 387, 516	162, 992
2013	121, 050	81, 896	29, 600	155, 580	A 358, 526 B 232, 546	64, 183
2014	59, 811	141, 817	381, 117	440, 166	A 641, 794 B 582, 745	296, 904
2015	398, 000	262, 970	----------	----------	660, 970	171, 582
2016	77, 457	95, 600	91, 760	189, 131	A 362, 088 B 264, 717	105, 957
2017	276, 050	127, 948	221, 973	338, 095	A 742, 093 B 625, 971	190, 539
2018	45, 692	146, 332	330, 950	587, 224	A 779, 248 B 522, 974	236, 829
2019	108, 679	15, 000	452, 938	867, 158	A 990, 837 B 576, 617	320, 763
2020	213, 000	60, 000	----------	----------	273, 000	79, 647
2021	90, 000	45, 000	----------	----------	135, 000	21, 435
2022	18, 625	53, 190	45, 510	138, 987	A 210, 802 B 117, 325	50, 109
2023	500, 265	365, 000	32, 883	32, 883	898, 148	295, 785
2024	29, 150	157, 695	158, 755	363, 710	A 550, 215 B 345, 600	107, 019
2025	14, 180	98, 640	68, 736	268, 736	A 381; 556 B 181, 556	95, 792
2026	151, 243	91, 000	8, 645	8, 645	250, 888	70, 094
2027	24, 000	35, 200	158, 755	363, 710	A 422, 910 B 217, 955	66, 609
2028	142, 744	41, 000	36, 090	123, 909	A 307, 653 B 219, 834	95, 683
2029	87, 654	12, 000	41, 160	141, 316	A 240, 970 B 140, 814	52, 751
Total	2, 899, 260	2, 547, 245	3, 106, 888	5, 499, 396	A 10, 945, 901 B 8, 553, 393	2, 878, 986

The Chairman. Then suppose you give me a definition, please, of semiliquid assets.

Mr. Hackett. Real estate, life-insurance contracts, and such properties as are not available to pay taxes.

The Chairman. Yes; that is right.

Mr. Scoll. Was any attempt made, Mr. Hackett, in any of these cases to effect a public distribution of securities in the case of some of these companies where the family head or proprietor died, or might soon die; and, therefore, public distribution was effective of the stocks without a change in management, which is sometimes possible, and I believe frequently happens?

Mr. Hackett. In these cases, no.

The question has, however, come up time and again with clients who have said, "Maybe the solution is to list our stock," which would be a solution as far as this tax valuation problem is concerned.

But, as you have probably seen, recently there were some figures compiled, I think by the New York Stock Exchange, showing the cost of effecting a public distribution of stock of companies of various sizes, classified by their over-all worth. When you get down to the business that is worth less than a million dollars, the cost of a public offering, if my memory serves me right, is some place in the neighborhood of 20 percent.

Mr. SCOLL. You mean the cost of preparing a prospectus?

Mr. HACKETT. The cost of underwriting. The underwriting costs on security offerings of under a million dollars runs about 20 percent, which is a pretty substantial cost.

Mr. SCOLL. Of course, it might be, and is, a substantial cost, but such a cost would be a relative thing if the amount of proceeds derived from the listing and the disposition of the securities alleviated the tax problem and left the family management in control. So, it is not always a question of just dollars and cents; it is a question of what it is worth from the standpoint of what you want to accomplish.

Mr. HACKETT. That is true.

Mr. SCOLL. So, I go back to my question: In your experience have any of the four or five hundred cases you have handled ever attempted that?

Mr. HACKETT. Some have tried, and some have effected a public offering and distribution of stock. But the majority of the cases that I have had experience with, Mr. Scoll, are people the value of whose businesses are not sufficiently large enough to justify a public offering. A business that is worth $138,000 or $330,000 is not quite large enough. In the first place, you could not meet the recognized exchangers' qualifications for listing your stock because you are not large enough.

Mr. SCOLL. That might be true of the Big Board; but for local distribution?

Mr. HACKETT. The department does not recognize, in disputes on valuation, the small exchanges, such as the Cincinnati Stock Exchange. The Big Board and Curb are recognized.

Mr. SCOLL. You were talking about establishing value for tax purposes?

Mr. HACKETT. For tax purposes.

Mr. SCOLL. I am not talking about that.

Mr. HACKETT. To raise cash?

Mr. SCOLL. I am talking about distributing securities solely to raise cash.

Mr. HACKETT. Well, some of the larger of the small businesses that I am familiar with have listed their stocks for two reasons: One, to raise cash and, two, to meet the valuation problem at death. But the average small man, is seems, likes to keep his business to himself. And you would be surprised how many will not even bring in their key men as stockholders during their lifetimes. It is something they have built and want to maintain control of.

Mr. SCOLL. Of course, I go back to my point again: that is a factor that cannot affect the decisions of the public taxing agencies in the application of the Internal Revenue Code.

Mr. HACKETT. No. But we are considering here the willingness or lack of willingness on the part of the investing public to buy into small companies. I think it can be said, although as a generality, that the average investor is not anxious to put his money into a minority holding in a small close corporation. I know I would not, in light of my experience with these tax problems.

Mr. SCOLL. Do you have any idea or any figures numerically to show how many of these companies you handled have attempted to issue securities to the public?

Mr. HACKETT. I do not have any such figures. I could get them, but I would say, offhand, mainly because of the size of the estates I am dealing with, you could count them on the fingers of your two hands.

The CHAIRMAN. I think there is another question that should have been asked here in connection with the tax and the liquid assets in relation to these cases, and that is the period during which the tax may be paid.

Mr. HACKETT. Up to 15 months after date of death, and at that time interest begins to run against you. You pay the Government interest after 15 months, and I believe it is at the rate of 6 percent.

Mr. SCOLL. But you can still extend it from year to year.

Mr. HACKETT. You can extend it, but then you are getting into not only interest costs, but all the other related costs; and they are not low, I can assure you. Your increased attorney's fees and administrator's fees, when you extend the administration of an estate, further aggravates your liquidation problem.

The CHAIRMAN. There is no such thing, then, as an installment payment?

Mr. HACKETT. To the Government on death taxes?

The CHAIRMAN. Yes.

Mr. HACKETT. Not that I know of.

Mr. SCOLL. But there is a right to extend from year to year up to 10 years.

Mr. HACKETT. That is right, any pay interest in the meanwhile.

The CHAIRMAN. And the interest rate is what?

Mr. HACKETT. I believe 6 percent.

There is only one more thing I would like to say, and I gather that, to a degree, I have made my point that there is a problem confronting an investor in a small business, when his estate is valued for death-tax purposes. Naturally that leads to this: What can be done about it?

As I see it, the thing we mentioned a short while ago would help to so clarify the estate-tax laws and regulations on this question of the valuation of close-corporation interests that you would give the holder of an equity position in a small corporation a maximum point-of-tax valuation that would be somewhat lower than the point at which the authorities can now start.

Secondly, two suggestions have been made in the past but have never received any action and I do not know how much consideration.

One has been to permit—and this would not only apply to the property holder who has an interest in a small business but to all taxpayers—the individual to acquire during his lifetime some form of Government bond, redeemable at death for payment of death taxes, but a bond which itself would not be subject to death tax; or, two, permit the property owner——

Mr. SCOLL. That would be a non-interest-bearing bond?

Mr. HACKETT. It could be a non-interest-bearing bond.

Or, two, permit the property owner who has a taxable estate to take out, if he is insurable, life insurance payable to the United States Treasury, which insurance would not be subject to tax at death, but which would furnish liquidity. It would be tax-free only to the extent that it is used to pay taxes.

This may be too simple a remedy, but it seems to me it would be a step in the right direction if the average person who is in the process of accumulating an estate, and particularly these men with small businesses, were given an opportunity to build up during their lifetimes a reserve, just as they do in corporate financing, to cover this potential liability that they are all faced with.

Mr. SCOLL. The premium on that insurance would not be deductible expense?

Mr. HACKETT. Not necessarily. They need not be. That is not significant.

Mr. SCOLL. That would come out of income.

Mr. HACKETT. It would come out of income.

Mr. SCOLL. Have you any further suggestions?

Mr. HACKETT. No; those are the only suggestions I have to make.

Mr. SCOLL. Have those suggestions been made before any of the regular legislative committees dealing with taxes, like the Joint Tax Committee or the Ways and Means Committee?

Mr. HACKETT. I do not know, Mr. Scoll.

I know from reading the various tax services over a period of years that both of these proposals have been brought to the attention of the authorities, but whether they have been brought to the attention of Congress, I am not sure. I know that at one time or another they have both been suggested.

Mr. SCOLL. By "authorities," you mean to the attention of the bill?

Mr. HACKETT. They have been brought to the attention of the Internal Revenue Bureau, and whether they have gone higher than that, I do not know.

The CHAIRMAN. Does that conclude your testimony?

Mr. HACKETT. That concludes my testimony, and I thank you for giving me this chance to point out this problem.

The CHAIRMAN. Mr. Hackett, we thank you for coming here. I think it has been most helpful.

Tomorrow morning at 10 o'clock the committee will hear Mr. Phillip Reed, chairman of the board of General Electric Co., and in the afternoon representatives of the investment trust companies will appear.

The committee now stands in recess until 10 o'clock tomorrow morning.

(Whereupon, at 12:15 p. m., the subcommittee recessed, to reconvene at 10 a. m., Wednesday, December 14, 1949.)

VOLUME AND STABILITY OF PRIVATE INVESTMENT

WEDNESDAY, DECEMBER 14, 1949

Congress of the United States,
Joint Committee on the Economic Report,
Subcommittee on Investment,
Washington, D. C.

The subcommittee met, pursuant to adjournment, at 10:30 a. m., in the caucus room, Senate Office Building, Senator Joseph C. O'Mahoney (chairman) presiding.

Present: Senator O'Mahoney.

Also present: David Scoll, special counsel to the committee, and Theodore J. Kreps, director of staff.

The Chairman. Mr. Reed, the committee is very happy to greet you this morning and to receive your expression of views on this very important question of investment.

Do you have a prepared paper?

Mr. Reed. Yes; I have.

The Chairman. Then you may proceed with the paper and perhaps questions will be asked later on, if you prefer it that way.

Mr. Reed. Thank you very much.

STATEMENT OF PHILIP D. REED, CHAIRMAN OF THE BOARD OF DIRECTORS, GENERAL ELECTRIC CO.

Mr. Reed. I am Philip D. Reed, chairman of the board of General Electric Co.

It is a privilege to be asked to discuss with your committee the factors which affect the volume and stability of private investment in the United States. Investment plays a vital part in the progress of the country and in the maintenance of a high rate of production and employment.

Because any man's opinion is naturally a product of his own experience and of the experience of the industry to which he belongs, I would like to mention a few points concerning the electrical industry because these have a bearing on the comments which follow.

The electrical industry started in the closing decades of the last century as a small industry. It grew rapidly in importance and because of the nature of its product and the service which this product renders to users it has come to occupy a key place in a modern economy.

Orginally the electrical industry started because of the imagination, vigor, and determination of a few men to create and make available to mankind something which was essentially new. The subsequent growth of the industry was likewise based on the ability of men to invent, build, and market things which had never existed before. Our industry always has been and still is a pioneering industry.

The objective of electrical products is to make this world a better place in which to live. This they do by increasing human productivity in every field of endeavor—that being the only way by which the living standards of a people can be raised. In addition, they provide valuable new tools and services in the fields of medicine, sanitation, communication, education, transportation, entertainment, and many others.

The products of our industry are, by and large, capital goods—durable products—which are looked upon by the purchaser as an investment. Thus the equipment, or apparatus as we term it, used by industry for manufacturing processes, by utility companies for the generation, transmission, and distribution of electric energy, the equipment for ships or railroads or hospitals or broadcasting stations, are purchased by someone investing capital derived from the savings of individuals or the retained profits of a business. Expenditures of this kind are influenced by the outlook for business in the products or services produced by the purchaser.

Electrical products for the home are in much the same position. Most such appliances are designed to last for years and constitute capital investments for the family. The demand for them also depends to a degree on the economic outlook, the prospect for steady jobs, savings, and expendable funds.

A substantial percentage, therefore, of the purchases of products of the electrical industry are of a postponable character. If the outlook for the sales of industry do not appear promising, many companies frequently hesitate to make capital investments. If the outlook for jobs seems to be unpromising, many families hesitate to buy appliances.

The electrical industry, therefore, is interested in the maintenance of a high national level of production and employment, and one of the key factors which brings this about is a large and reasonably stable volume of private investment.

For many years prior to World War II, General Electric's business was conducted substantially entirely on equity capital—that is, on the amount paid in by stockholders plus retained earnings. However, our extensive postwar program of reconversion. modernization, and expansion, plus the increased capital required to finance our greatly increased volume of business made necessary our borrowing $200,000,000 in December 1946; $50,000,000 was borrowed from banks and has since been repaid; $150,000,000 was borrowed from a group of insurance companies on 20-year notes, and $7,500,000 of this has been repaid.

At September 30, 1949, the equity capital plus borrowed money in our business was approximately $752,000,000, divided as follows:

Paid in by stockholders (including profit on sale of treasury stock)	$194,000,000
Undistributed earnings	388,000,000
Borrowed money	170,000,000
Total	752,000,000

General Electric's sales in 1929 were approximately $400,000,000. They declined substantially in the 1930's, and it was not until 1940 that we again achieved $400,000,000 of sales.

During the war, of course, our volume expanded very rapidly. It declined somewhat in the immediate postwar years, but in 1948 our sales were approximately $1,600,000,000, or four times what they were in 1940.

Price increases of approximately 37 percent account for part of this increased dollar volume, but our actual physical output of electrical products of all kinds increased 2.6 times from 1940 to 1948.

The interesting thing about this extraordinary progress is that with all we have done to create new and better products—and I assure you we have worked hard at it—the General Electric Co. has just about held its own in relation to the growth of the electrical industry.

And this has been true for a great many years. In 1930, for example, we estimate that our percentage of the electrical industry was about 23 percent; our best estimate is that in 1940 we did about 25 percent of the business; and today the figure is approximately 24 percent. Thus, no matter how much our output has grown, we have only kept pace with the growth of industry and the country at large, as measured in terms of the ever-increasing living standards and needs of the American people.

It will be clear to you, I am sure, that the business of the General Electric Co. creates a multitude of business and investment opportunities for others, principally small business. Take, for example, one of our products, the J–47 Turbojet engine. I had occasion recently to look at a partial list of the subcontractors and contractors furnishing materials and parts to us for our use in the production of that engine. It was not a complete list, but on it there were 208 company names, contributing their skill, creating jobs, and, I hope, making a fair profit out of their part in the creation of this product.

During the war General Electric received a large number of contracts through the various procurement agencies of the Government, contracts through which it undertook to design and produce a variety of new products and devices required by modern warfare. But it most assuredly could not have done that work alone.

In connection with the performance of all our war contracts, we have estimated that we had the cooperation and assistance—the partnership, if you will—of over 2,500 subcontractors.

Our purchasing department has given me the figures on the number of companies which supply us with the materials, the components, the parts which we buy to incorporate in the products which we make and sell. Their best estimate is that we do business with 31,000 such suppliers.

Having purchased these products and, through the combined efforts of our employees, fabricated and assembled them into completed products, we sell them through some several thousand distributors to an estimated 200,000 dealers, to be in turn resold to the American public.

Thereafter, other thousands of electricians and repair shops stand ready to service the products throughout their lifetime. These hundreds of thousands of people who thus handle our products are almost without exception small-business men.

The fruits of our research laboratory are also widely used by other manufacturers, frequently competitors, and very often small businesses. We pursue a very liberal licensing program under which all requests for a license under any of our patents are carefully reviewed.

We have outstanding today 638 separate license agreements under more than 3,500 patents covering a wide variety of products. In addition, we have already submitted to the Patent Office for listing on its register 2,300 patents as being available for licensing to any applicant on a reasonable royalty basis, and more will be added from time to time.

Furthermore, it is our policy to grant licenses to any applicant on a reasonable royalty basis under all patents which we are not now using or which we have no plans for using within a reasonable period.

The purpose of these preliminary remarks, Mr. Chairman, is to emphasize that those factors which stimulate investment in the large durable-goods industries react inevitably for the benefit of all American business, large and small, making for new jobs and better incomes for all workers.

This, in turn, means that the American consumer is able, and hence willing, to make the purchases which constitute his "investment" in the future betterment of our economy and our national standard of living.

I turn now to a group of questions which your special counsel, Mr. David E. Scoll, suggested I comment on. They appear in appendix A at pages 211 and 212 of the document printed for the use of your commitee and headed "Factors affecting volume and stability of private investment."

Because a number of these questions are not applicable to a company of our size and diversity, I will deal only with those which appear to be pertinent and will be glad to try to answer such specific questions as you may have at the conclusion of my prepared statement.

I. "What kind of pay-off periods do you require on new equipment investment?"

We have no fixed standards for appraising the advisability of new equipment expenditures on the basis of predetermined pay-off periods. Each request for an appropriation is considered as a matter of business judgment on the basis of the facts peculiar to it.

Obviously, in our company this would have to be so because the element of risk involved in different classifications of our business varies considerably. For example, a tooling project for a new line of television receivers might require an expenditure of many thousands of dollars, which would only be warranted because of the obsolescence and styling characteristics of the business, if the expenditure paid off within a period of less than a year. On the other hand, because of the relatively sustained and stable demand, our investment in our new turbine building is warranted on the basis of a pay-off period extending over a long period of years.

I. (a) "Do the rates of depreciation, which you and your accountants feel proper, differ from those allowed for tax purposes?"

The depreciation rates which we use for accounting and cost purposes are slightly higher than those which we are allowed to use for tax purposes. However, for both purposes, we merge groups of related assets and depreciate them on a composite rate basis which contemplates that certain of the assets will go out of service prior to attainment of the average life and others will remain in service for a period longer than the average life.

Because of this grouping, we have very little occasion to revise depreciation rates except at infrequent intervals. The principle involved is very much like that which a life-insurance company employs in establishing its rate structure.

II. "How are replacement expenditures planned?"

Under our system, we require an annual budget of all capital expenditures whether for replacement or expansion, together with a forecast of such expenditures for the 4 years following the budgeted period.

This budget and forecast, however, is largely for the purpose of determining the over-all capital requirements of the business since approval of the budget does not constitute authority to proceed with the individual projects incorporated in it.

By and large, the plans for specific capital expenditure projects originate in the operating divisions. These divisions prepare appropriation requests for authority to make specific expenditures. In the case of the smaller projects—those under $100,000—these requests are screened at the departmental level.

In the case of the larger projects which require approval by the board of directors, the requests are reviewed and passed upon by an over-all company appropriations committee. Both the departmental and over-all company appropriation committees include representation from the various functional activities of the company.

As is the case with pay-off periods, it is not possible to make any categorical answer to the questions concerning the time required for planning capital projects and the facts or forecasts upon which they are predicated. In some instances involving very large projects such as the research laboratory, the preliminary planning is undertaken several years before the project is finally approved; in other instances a project may be planned, approved, and completed within the same calendar year.

III. "How are new opportunities for profitable investment discovered and ripened into investment commitments?"

Our principal sources of new products, new processes, and new materials are the General Electric research laboratory, the general engineering and consulting laboratory, and our various product engineering divisions. Our research laboratory was the first industrial research laboratory in the United States and in a few months will complete its fiftieth year of operation.

The research laboratory is engaged principally in pure research in all fields of the physical sciences and to a lesser extent in applied research in the solution of specific problems either developed in the laboratory or brought to it by other parts of the company.

The discoveries of the research laboratory are brought to the development of new products and processes—in effect, put to work—by the general engineering and consulting laboratory and the engineers of our operating divisions which use those discoveries to develop specific products or applications.

There is a regular system of contact and liaison providing a constant flow of information between these groups and the research laboratory. Important discoveries, developments, and new products are subject to formal review by our engineering council.

In addition to considering the use and application of these discoveries and processes in our existing products and operations, it is an important function of the engineering council to review them with an eye to the development of new businesses and end-use products. The recommendations of the council in this field are transmitted to the marketing committee, which, as the name implies, appraises the project from a commercial and general business point of view.

In this connection we rely very extensively on market and consumer studies. The combined recommendations of the engineering council and marketing committee are subject to review by the president and, if a substantial investment is involved, by the board of directors.

The process here only briefly described is a very active determinant in the investment of capital for the expansion of old businesses or development of new. In this connection your committee may be interested to know that the cost of outside businesses acquired by the General Electric Co. during the past 25 years is less than 2 percent of the present assets of the company.

IV. "To what extent must the possibility that others are simultaneously contemplating investment be considered in arriving at your decisions?"

Insofar as information concerning the action and plans of others in our industry is known to us, it is carefully considered in making our own plans. We try, just as they do, to be on the market first with the best product.

V. "How long a time elapses between the time a decision to invest is made and the time when products from the facilities are available for meeting market demands?"

Again it is not possible to give any categorical answer to the question. In the case of a large project such as the turbine building, two or more years may elapse between the date of decision to make the expenditure and the actual production of goods from the facilities. On the other hand, a facility for the manufacture of small appliances may be in production within a matter of a few months from the date on which the commitment is made for the capital expenditure.

VI. "In what way does the availability or unavailability of funds enter into programing once an investment opportunity has been recognized?"

Our philosophy has always been that suitable financing can be obtained for a sound project. Any investment opportunity which we consider attractive should pay a considerably higher return over the years than the interest rate we might be obliged to pay on any money borrowed for the purpose.

VII. "When are decisions made and investment plans undertaken in relation to the peaks of production demand?"

Historically, it is a fact that our principal capital expenditures have been made in the prosperous years, and logically it may be doubted whether this can be otherwise in the future. Any self-imposed "automatic" checks which would deter expansion in periods of high demand would be bound to place us ultimately at a serious competitive disadvantage, and it seems to me that any national or industry-wide checks of this nature might well delay the introduction of new products to the American public. For example, would the country really be better off if all capital expenditures for the production of television had been deferred until the time of the next business recession?

There are, however, certain investments for replacement or modernization which can and should be deferred wherever possible to periods of reduced activity.

VIII. (b) "Do you ever help finance the purchase of your product or your raw materials?"

Yes, on occasion. We sometimes sell our apparatus on deferred-payment terms. During the 1930's we financed many of our distributors who were in financial difficulties and frequently provided experts to help them operate their business more efficiently. We also own the General Electric Credit Corp., whose business it is to assist in financing the sale of electrical products—principally home appliances—to those who wish to purchase them on an installment payment plan.

IX. "Does your company have any plans in respect to either foreign sales or foreign investments?"

Since the earliest days of the company we have been interested in foreign markets and have made substantial investments in both selling and manufacturing companies abroad. Through these operations and investments our research, engineering, manufacturing, administrative, and management know-how are transmitted to many foreign countries.

Our foreign investments have been made through and in the Canadian General Electric Co. and the International General Electric Co. (IGE). IGE represents the General Electric Co. in all countries of the world outside of the United States and Canada.

Since the war, in the 4-year period July 1, 1945, through June 30, 1949, there has been a gross increase in our foreign investments of some $35,000,000, represented by goods, apparatus, machinery, et cetera, paid for with United States dollars. Further, we have made investments in foreign currencies in the form of undistributed earnings, local borrowings, and other receipts.

Although these foreign currencies in some cases were not and are not convertible into United States dollars, they represented the equivalent, at exchange rates prevailing at the time, of some 50 million United States dollars. This âmounts to a total investment since the war equivalent to $85,000,000. Some 95 percent of this total went into our own foreign affiliated companies, that is, companies owned or controlled by General Electric.

Against this gross investment, there have been certain repatriations. For accounting purposes we, of course, use conservative valuations of these new as well as the older investments, particularly where funds are blocked or foreign exchange difficulties exist.

The difficulties and risks associated with doing business abroad are perhaps greater today than ever before. Here are some of them:

(A) In many countries the political situation is very shaky and the possibility of civil strife and damage to property must be considered.

(B) Strong nationalistic feelings exist in many countries which result in an unfriendly attitude toward foreign companies; discrimination against them; threats of nationalization; no assurance of prompt, effective and adequate compensation in the event of nationalization, et cetera.

(C) The dollar shortage has produced convertibility problems in almost all countries, and with it exchange controls, import quotas, and all manner of restrictions which greatly obstruct the transaction of business. In some cases dollars cannot be obtained to pay the salaries of United States nationals working in foreign subsidiaries of American companies.

(D) In Mexico we have frequently been unable to get entry permits on a long-term basis for sufficient skilled technical, managerial, and administrative personnel which is essential to the operation of a new factory. China, of course, presents an example of a country where foreign staff is not permitted to go in or come out without great difficulty and a certain amount of danger.

(E) In some countries, India and certain other British Commonwealth countries, for example, the income taxes are so high that American personnel have no incentive to go there even at substantially higher salaries than they receive in the United States.

X. "What can be done by organized efforts of business or by government to minimize the variability of gross-investment expenditures?"

This, of course, is the $64 question. I will try very briefly to suggest several areas that seem worthy of your committee's careful consideration.

(A) First, with reference to encouragement of foreign private investment, it is clear to me that our Government can play an important part. Essentially what is needed is a real desire on the part of foreign countries for American private capital and know-how to come to their countries. There must also be a willingness on their part to give the necessary assurances with respect to convertibility, nondiscrimination, expropriation, freedom from double taxation, et cetera. I believe our Government should make it quite clear that Government funds will not be provided in fields for which private investment and know-how would be available if the proper climate for private investment were created.

I further suggest that our Government be not overeager to do favors or grant assistance—even within the clearly governmental field—to countries that are unfriendly toward and discriminate against American private capital. If these things are done, the day will be hastened when those foreign governments which persist in a policy of extreme nationalism will have to answer to their people for the results.

(B) I believe there is a very good argument for liberalization of the present treatment of depreciation for tax purposes. In the first place, the use of a low depreciation rate in itself tends to delay the purchase of new equipment because the loss to be taken if a tool is scrapped will, in many instances, constitute a substantial deterrent to its replacement by a more modern facility.

Furthermore, decisions to add or expand facilities are necessarily predicated upon fairly short term economic and market projections. These decisions would certainly be stimulated if management knew that a substantial portion of the capital investment could be written off over the period of foreseeable sales volume.

I think we are obliged to agree that the permissive use of higher depreciation rates will not solve the problem of leveling out business capital expenditures. I do think, however, it would help to level out Government's income because the tendency of business would be to use the higher rates in years of large volume and thus have less to carry forward to years of low volume. Specifically, I would recommend:

(*a*) A statutory option to amortize 25 percent of the cost of a new facility over the first 5 years, depreciating the remaining 75 percent—starting at the same time—on the basis outlined in (*b*) below.

(*b*) With respect to the remaining 75 percent, either (*i*) a return to the principle that the taxpayer may use the rate selected by him unless the Bureau can prove this to be erroneous, or (ii), a permissive allowance equal to 125 percent of the depreciation rate determined by the Bureau.

(C) I believe the present double taxation of dividends is not only inequitable but is a serious deterrent to investment in equity securities. I strongly recommend that a tax credit be given to the individual recipient of dividends equal to the amount of the tax paid thereon by the corporation which paid the dividend.

(D) I recommend that the Government continue to provide and encourage wider use of statistical and economic information bearing on the market demand for products. There has been of recent years considerable growth in the use of factual material showing the position and trend of the economy in many important respects. This is all to the good, and every effort should be made to improve the data and broaden their dissemination.

(E) I am not a proponent of compensatory or supplemental investment spending by Government in periods of declining private investment. In my view tax reduction of an equivalent amount would be more effective as a direct stimulant to private investment.

This is not to say that the Government's ordinary public works expenditures should not, insofar as possible, be deferred in periods of inflation and stepped up in periods of recession. While this practice is sound in theory, one wonders whether as a matter of practical politics much can be accomplished along this line.

(F) More imprtant than any of the points above mentioned is the matter of the Government's fiscal, monetary, and debt management policy as affecting the stability of private investment and the over-all economy. I realize this is the subject of a separate inquiry by another subcommittee of the Joint Committee on the Economic Report. But as the volume and variability of investment is so importantly affected by the Government's fiscal, monetary, and debt-management policy, I wish to record that I have read the statement made before that subcommittee on November 23 by Mr. J. Cameron Thomson on behalf of the Research and Policy Committee of the Committee for Economic Development, of which I am a member. I thoroughly agree with the views he expressed and commend them to your careful consideration.

Again may I say, Mr. Chairman, how much I appreciate this opportunity to appear before your committee, and your courtesy in listening to this—perhaps too lengthy— statement.

The CHAIRMAN. No, indeed, it was a pleasure to hear you, Mr. Reed.

Mr. Scoll, do you have any questions at this point?

Mr. SCOLL. Not at this point, sir.

The CHAIRMAN. Dr. Kreps?

Mr. KREPS. I have a few, probably starting from the back end of the paper, because that is most recent in our minds.

Mr. Reed. Very well.

Mr. Kreps. Under recommendation (E) on page 16 you say:

> In my view tax reduction of an equivalent amount would be more effective as a direct stimulant to private investment.

I just studied the actual tax reduction that occurred in 1931–32, and it amounted in all except the very largest corporations to 100 percent. In other words, tax reduction incentive does no good unless you have net income.

Mr. Reed. That is true, where you are in a period where there are losses being incurred all along the line, why, of course, tax reduction does not mean anything if you are not paying any taxes anyway.

Mr. Kreps. The problem is that small business in particular tends to suffer in such periods. Figures of the Federal Trade Commission indicate that in the mild type of disinflation we had this year certain of the small businesses already began to be in this area in which tax reduction would not do them any good.

Now the question is: How do you then stimulate investment expenditures?

Mr. Reed. Even though you may be in a period where a corporation has little or no income, we are talking here about new investments, I take it.

Mr. Kreps. Yes.

Mr. Reed. Investment of fresh funds and, of course, the decision as to whether or not that investment shall be made must necessarily include within the formula the current tax rates.

Now, if tax rates had been reduced, even though on the other phases of the business it did not represent much of a factor in terms of the current rate of business and current rate of profits, still, looking ahead and determining whether or not you are going to make an investment, a lesser corporate tax would be a favorable factor toward making a decision to invest. How much it would be, your guess would be as good as mine, but it would be a favorable factor.

Mr. Kreps. The historical fact is that the highest volume of investment expenditures have been made in periods when for other reasons the tax rate also was highest, and the tax take was highest. I am not saying that there is any connection between them, you understand that, but I am impressed by the fact that our real problem is: How do we get firms to invest when they do not see a definite prospect ahead for profitable application of new funds in their industry, when the economy looks bleak, as it did in 1931–32, to some extent 1938, 1921, and so forth. Those are the periods in which we would like to have increased investment. How does one get a strong flow of investment expenditures at such times?

Mr. Reed. Generally speaking, the capacity, the productive capacity of industry in periods of the kind you speak of, periods of recession or of depression, substantially exceeds the current demand, so that new investment tends to be in the area of investment for cost reduction, a new machine which will substantially reduce the cost of the product to be marketed, so that it can be marketed at a lower price, which may again tap a demand which does not exist at a higher price.

So that we are not alking so much about expansion of over-all facilities as the problem of that type of period, but rather the opportunity to spend money to reduce costs and thereby permit lower selling prices at a profit which is, of course, the problem of that period.

Mr. KREPS. Do you feel that anything could have been done taxwise in 1931 or 1932 to have stimulated investments in those periods when there was said to be excess capacity at least in terms of what the market would then take at prices which then obtained?

Mr. REED. You are talking about a period that is so extreme that I just do not know. I do not know. I would have to think about that.

Mr. KREPS. 1921.

Mr. REED. It seems to me when we are talking about the period of 1930 to 1933, we are talking about a period so extreme that none of us believes or anticipates it is going to happen to us again, and I doubt whether our plans should be laid on the assumption that we are going to experience that kind, that deep, that sharp an economic difficulty in this country.

Mr. KREPS. Another proposal you make is that the double taxation of dividends——

The CHAIRMAN. Before you get into that, Dr. Kreps, pursuing the point on which you were just interrogating Mr. Reed, may I call your attention to your statement at page 3:

> General Electric's sales in 1929 were approximately $400,000,000. They declined substantially in the thirties and it was not until 1940 that we again achieved $400,000,000 of sales.

Now, there is a statement that in the period of so-called Government spending to counteract the depression, an era of compensatory investments, so to speak, by the Government, General Electric recovered from the low of the depression to a level equal to that which it had attained in the prosperous days preceding the depression.

Now, does that statement of fact from the experience of General Electric in any way modify your conclusions on page 16 under (E)?

Mr. REED. No, sir. It, after all, took us 11 years to get back to that $400,000,000 figure, between 1929 and 1940, and my own view is that the policies, the spending policies of the Government, did not importantly contribute to our getting back to the $400,000,000 figure.

I do not see any point in arguing academically as to whether or not had the policy been different, we might have gotten back to $400,000,000 at an earlier date or an earlier year, because I could not prove it, but I do not feel myself that the policy insofar as it involved pump priming, as we then called it, importantly contributed to the recovery.

The CHAIRMAN. Well, at least it did not prevent recovery, did it?

Mr. REED. Sir?

The CHAIRMAN. At least, it did not prevent recovery; is that right?

Mr. REED. No, sir, because the fact is we got back there in 1940 to something over $400,000,000.

The CHAIRMAN. Speaking of the person who was here during all that time, I know that there were no voices raised against the Government policy at that time. I know that the Roosevelt administration started out largely on the theory which you have here expressed as your recommendaion on page 16. The very first recommendation that Mr. Roosevelt made to the extra session of Congress, which he called in 1933, was to cut Government spending all the way down the line, and Congress did that.

It reduced the payments to veterans, for example. It cut Government salaries. It shut off expenditures on every possible avenue. Mr.

Louis Douglas, the present Ambassador to England, was at that time Director of the Bureau of the Budget. I happened to be First Assistant Postmaster General at the time, and I had my own personal arguments with Mr. Douglas about what the budget should be for the Post Office Department. When it was decided to cut the salaries of the post office employees and grant them payless furloughs, it became my responsibility to go around the country to the meetings of the post office clerks and carriers and tell them what a patriotic thing they were doing to support the Government by accepting these reductions.

Unfortunately, those reductions did not produce any results, and the administration was forced to completely reverse its program. There was no dissent at that time in Congress which amounted to anything, because there was no other remedy that was visible.

Mr. REED. Don't mistake me, Senator. In the period that we went through I think it is essential, obligatory, on a government, be it Federal, State, or local, to take care of people who are willing and ready to work but are unable to do so and are suffering as a result. I thoroughly agree with that, and I very much hope that some of the fine things that have been done in the intervening period in the way of social security, unemployment insurance, and others represent one of the great factors that will prevent a recurrence of that kind of condition.

What I had in mind was that apart from the Government spending for that purpose, a planned spending to spark plug a recovery, I would question. I have the feeling that other things can be done more effectively to stimulate a change in trend in our kind of a free economic system than what was done, but that, as I say, is a matter of opinion.

The CHAIRMAN. I take it that you want your answer here to be interpreted in the light of more or less normal times rather than in the light of expenditures by Government in an emergency.

Mr. REED. The purpose of this hearing, as I understand it, is to consider those things which Government might do that would assist toward a larger volume of private investment and more stable level of private investment in American industry.

My view is, as I have indicated there—and it is all it is intended to convey: That to that question I would think tax reduction would be more stimulating to the maintenance or restoration of a higher level of private investment than would Government supplementary or compensatory investments of Government funds. That is the only point I am trying to make there.

The CHAIRMAN. Your phrase "in periods of declining private investment" refers only to declining private investment and not to these other considerations?

Mr. REED. That is right.

The CHAIRMAN. The history of the period following World War I so far as tax legislation was one in which the argument was consistently made that reduced taxation would promote Government income, by stimulating business. For a time substantial payments were being made on the debt, on the World War I debt. Nevertheless each of the five consecutive tax-reduction bills passed during that period was followed, not by an increase in Government revenue but, by a decrease of Government revenue. When the depression finally did come and the revenues of the Government took a toboggan slide because there were no incomes upon which taxes could be paid, the budget went out of balance, the national debt rapidly rose again. By the time the change was made in 1933 the national debt was less than $2,000,000,000 below what it had been at the beginning of the other period.

That is a historical fact.

Mr. KREPS. As long as we are on this subject, I would like to continue just a bit further.

In your answer to question VII at the bottom of page 10 your first sentence led me to believe you were recommending tax reduction as a remedy for the type of serious cyclical variation which I implied in my original question. You say there:

> Historically, it is a fact that our principal capital expenditures have been made in the prosperous years, and logically it may be doubted whether this can be otherwise in the future.

That, to me, implies that the swings of capital investment expenditure that characterized the past, seem to you to be hard to mitigate, or as you say, it is logically doubtful whether such can be done.

Insofar as that statement is true—and I can see various reasons why it should be—the 1929 phenomenon merely represents, as you indicate, in somewhat special form the kind of cyclical instability that is particularly under consideration by this committee.

Now you realize that no one ine 1929 expected a cyclical decline no more than they do now; certainly not one of the magnitude that occurred. There seemed all kinds of reasons why so severe a depression could not happen. As is stated in this staff's study of factors affecting the volume and stability of private investment:

> Relative to the present, labor unions were weak; taxes were low;

and, as you remember, they were reduced promptly in the fall of 1929—

> all governmental budgets were in balance; there was no problem area beyond the iron curtain nor menacing socialism elsewhere, nor programs of reform at home; security markets were unregulated, the stock market at new highs; corporate profits zooming, and political administrations here and abroad entirely favorable to business.

You see how, when you are trying to study the problem of stabilization, this most unstable of all elements in the gross national product, namely, private investment expenditures brings the 1929 puzzle recurrently back to mind when recommendations such as you have made, sir, are considered.

Does not your statement on page 10 in essence imply a more or less fatalistic view? In the same way investment expenditures went down from 15.8 billions in 1929 to only 886 million in 1932; is it not logically doubtful whether present levels of gross private and domestic investment of 45 billion dollars can be prevented from going down well below 25 or 20 billions? If such should happen, I need hardly say that there would be a considerable volume of unemployment. This committee would certainly be derelict in trying to fulfill its obligations under the Employment Act of 1946 if it did not try to find some way of stabilizing capital investment expenditure. As I get it, your feeling is that nothing much can be done.

Mr. Reed. No; I did not say that at all. What I said was, and I will repeat it:

> Historically, it is a fact that our principal capital expenditures have been made in the prosperous years, and logically it may be doubted whether this can be otherwise in the future.

That is true with reference to new facilities, where demand is high, where new facilities are required in order to meet that demand. It is, in my judgment, not in the interest of the American economy or the American people as a whole to withhold the expenditures necessary to create such facilities to meet the demand. If you do not, prices are going to go up as they always do when there is a shortage of supply, and you are going to make the situation worse rather than better.

My view is that one cannot deliberately decide not to put in facilities that are known to be needed to meet current demand in a period of prosperity. That does not mean, as I indicate at the end of that same comment, that other expenditures—the installation of a new power plant, if you will, the modernization of an old factory that needs to be done, but which does not have to be done at a particular moment—cannot and should not be deferred until periods of light business activity.

Mr. Kreps. I raised the question there, Mr. Reed, because I wondered—referring to the top of page 10—what kind other than governmental expenditures—which I, for one, would wholly agree should be deferred from prosperous periods and reduced to a minimum in prosperous periods, and possibly increased insofar as possible in periods of relatively considerable stress—what can private enterprise do? What did you have in mind when you said that certain investments for replacement and modernization can and should be deferred where possible to periods of reduced activity? I take it you have some sort of practical idea in mind, and you might amplify that for us.

Mr. Reed. Yes; I would be very glad to.

As I said, there are two categories of expenditures: one for expansion to put in additional facilities to meet enlarging demand, and the other is replacement, maintenance expenditures to keep the present capacity modern and efficient.

Now that involves ultimately replacement and repair of buildings; it means replacement of equipment itself; it means renewal of various services—boilers, generating plants, all kinds of things—that are essential to the operation of industrial enterprise.

Anything that has not actually gone out of service, has not failed, and is within the limits of existing capacity, as distinguished from requirements for extensions of capacity to meet prosperity demands, is theoretically, at least, postponable.

Now it may be desirable from the standpoint of efficiency and costs to replace a plant or replace a machine even at higher prices and in prosperous times. And a certain amount of that one does. But there are a great many appropriations and requested appropriations that come to us from our operating divisions for replacement of a testing equipment, or a boiler that is getting near the end of its life, or a new power turbine for that plant, or a straight building operation, where the building has in their view become outmoded and they could be much more efficient with a new one.

Those can be, and as far as we are concerned, in many cases are, deliberately set aside to be done at some later date. And those are the kind of things—and it represents in total a very substantial figure—that should be expended in the trough rather than at the crest.

Now the difficulty psychologically is that so often management becomes frightened by the downward trend, and it takes a certain amount of courage to decide to go out and spend fresh money when the curve of sales is sharply downward. That is a matter of education; it is a matter of planning and preparation, but a great deal can be done in that area.

Mr. KREPS. Have you made any estimate of the relative proportion, say, of total plant and equipment expenditures—well, let's assume a figure of 18,000,000,000—what percentage these postponable expenditures might be, and the relative proportion that might be said to be really new-venture capital?

In the total of gross private domestic investment, how much is really new-venture capital that we need and how much represents the type of postponable-replacement expenditure logically predictable from known markets and known deeds, et cetera, in which the venture element is not at all of the magnitude you have in new products?

Mr. REED. I cannot answer that. I do not know whether the Department of Commerce has assembled any figures on that.

Mr. KREPS. You are the only kind of a person, sir, that would be able to give us a really good figure. And I thought possibly from your experience you could give a guess. Your guess would certainly be better than anybody else's.

Mr. REED. As far as the division of it, I certainly would not want to make a guess, because it would be just that today.

I will be glad to see if I can figure something out which is a little better than a guess and send it along to you.

Mr. KREPS. It would be very helpful to us. We are trying to assess the magnitude of the venture-capital problem as compared with the entire problem of stabilizing capital investment. You have made one very useful suggestion, providing you tell us how management can educate itself so it will spend in periods of depression.

Mr. REED. I tried to distinguish in what I just said between expansion of capacity, increasing the actual physical output ability of the plant, and the modernization, maintaining up to date, of existing capacity. I think they are both venture. I think they are both essential if you are going to stay in business.

They are both venture capital, and there are many grades even within the maintenance of existing plant; there are many degrees of postponability, if you please. A building, for example, you can postpone longer, perhaps, than you could a machine which is definitely outmoded by a very much better one that has become available and you just cannot afford to be without it. So again business judgment must deal with those individual items.

But I will be glad to see whether we can get any helpful division of our total expenditures since the end of the war into those various categories.

I find that any significant analysis of our actual capital expenditures since the war would require a considerable period of time. Moreover, such an analysis might not be particularly helpful because our immediate postwar expenditures were, of course, considerably affected by the hiatus of commercial developments during the wartime period.

However, it may be of interest to state that in our planning for the 5-year period 1950–54, our capital budget has been segregated into the following categories:

	Percent of total planned expenditures
Increased production of existing products and manufacture of new products	23
Mechanization, rearrangements and other improvements for the purpose of effecting cost reductions	30
Replacements of existing facilities	30
Laboratory, testing and development facilities	5
All other expenditures, representing those for improved working conditions, warehouses, offices, power and service facilities, and so forth	12
Total	100

Possibly it is fair to assume that half of the third item listed above and all of the fourth and fifth items fall in the postponable category. On this basis, the timing of roughly one-third of our projected expenditures could be varied in accordance with business and economic conditions. I am not, of course, in a position to venture an opinion as to whether such a percentage is typical of industry in general.

The CHAIRMAN. At the outset of your testimony, Mr. Reed, you referred to the postponable character, as far as purchasing is concerned, of many of the products manufactured by your industry. And you stated that in periods of declining income customers very naturally and normally withdraw from the market for such goods. Then you told us that—

> The demand for these goods depends also to a degree on the economic outlook, the prospect for steady jobs, savings, and expendable funds.

I am quoting your language in that last sentence.

So it is to maintain this prospect for steady jobs, savings, and expendable funds that this committee was commissioned to make these various studies.

Our question always is, What can and what should Government do to provide this climate of which you speak?

We can recognize the fact that if Government investment, so to speak, is not available, and private investment is not available, then the answer is chaos. If we rely completely upon the Government expenditure, then the field for private investment is, of course, reduced. To what extent can we rely upon private investment, and what should we do to promote private investment? Those are our primary questions. Do you care to make any additional comment on that?

Mr. REED. And what other additional things can the Government do that do not involve direct Government investment to maintain stability of the over-all economy, including the rate of private investment. Some of the things that I think the Government can do are indicated in the final paragraphs of my statement. Each one of them, I think, would contribute to the objective that we both so earnestly seek, and particularly the final paragraph which deals with the fiscal, monetary, and debt-management policy of the Government.

The CHAIRMAN. These hearings started with the testimony of a group of small-business men, members of the advisory committee in the Department of Commerce. Then we proceeded to insurance and to representatives of other industries. We had a very stimulating paper the other day from Mr. Griswold, who is sitting here now as a most interested listener. He told the story of the American Research & Development Corp. and its efforts to put risk capital in new enterprise, and described a very successful effort in that respect.

But, by and large, our evidence is that the small business, the little business, does not have access at this time to capital needs.

It is generally stated that there is a dearth of equity capital.

But, on the other hand, it would appear so far as small business is concerned the owners of such businesses do not want equity capital beyond that which they put up themselves because they do not want to surrender ownership, which is a perfectly understandable point of view.

Mr. REED. Of course.

The CHAIRMAN. Now, if they do not want equity capital and cannot obtain debt capital, so to speak, cannot obtain access to reservoirs for loans, what are they going to do?

You are not only the head of a great industrial company but you are also, I think, a director of a substantial commercial bank. What method would you suggest to open this door? To me it seems that the door has got to be opened if we are going to maintain the system of private property.

Mr. REED. Well, I am wondering, Senator O'Mahoney, how tightly closed that door is. I think we must start from the proposition—as I understand it from data I have seen on the position, growth, number, and vitality of small business—that the position of that tremendously important segment of our productive economy is continuing to improve, is, indeed, on the whole, healthy and tough and vital.

I think Secretary Sawyer made a statement to that general effect within the last week. Now that does not mean that there are not problems there; I know there are. And to me, when a new enterprise, started, as you suggested, with funds of the family and immediate friends, has reached the stage where it has proven the marketability of its product, and then when funds in rather substantial amounts are needed for expansion of facilities in order to produce more, to distribute more widely, to carry larger inventories, and all the rest of it—there is the tight spot. Not necessarily because additional capital is unavailable, but because the price of it tends to be too high.

In other words, outsiders who put up the funds necessary to take that second large step, usually want a substantial participation, let us say, in the common shares of the company. And very often the father of the business feels that is an unreasonable price to ask. He conceived it, he built it to that point, and he ought to get the additional capital necessary at a very moderate rate.

So there lies the difficulty, the argument that exists between the entrepreneur and the furnisher of secondary capital.

The CHAIRMAN. In other words, you are telling us that from the point of view of the entrepreneur, at least, the owner of the secondary or additional capital is asking too high a price for it.

Mr. REED. I do not know that he is. I think there are times when he is, and I do not blame him for it.

The CHAIRMAN. As a banker, I would like to have you tell us about that. What would be the appropriate price for such capital. Should the demand for participation as well as interest be made?

I am not proposing anything to limit the demand of the owner of private capital. As long as it is private, why, of course, the owner of the capital has dominion over it. I am not talking about that, at all, but I am talking about the end result. And if the price is too high for this additional capital from the point of the entrepreneur and, therefore, expansion suffers, what are we going to do about it? Are we just going to endure it?

Mr. REED. As I say, I think we are doing pretty well. I think you are speaking of a very small minority of the cases. And while I would like to see those cases corrected, I think things can be done to correct them, nevertheless, I do not think that we are today in a position where this problem seriously is impeding the progress of America.

That is my conviction about it. That does not mean we ought not to observe the trends—perhaps it is getting more difficult. Perhaps if it is this way today, in another 5 years it will be worse. I do not know. But I think we should take a good hard look at it.

Now the type of capital you are speaking of is, of course, not the type a bank would furnish. This is long-term capital we are speaking of, and it would involve long-term debt or equity in one of its forms. Just what additional agencies can be created to meet that requirement, I do not know.

The undertaking that Mr. Griswold has described to you is certainly one and a very meritorious one. There are others of that general type. In my view, with that kind of situation, diversity is enormously important from the standpoint of the investor.

The CHAIRMAN. My difficulty in approaching this problem arises from the fact that I cannot bring myself to compartmentalize, so to speak, the situation in which we find ourselves. So many people talk about the prosperity which business is now unquestionably enjoying as though it were something separate and apart from Government expenditures.

Now, to my mind, it is not, because all business depends upon spending by somebody. Whatever the source of the spending is, there is business for business in the purchasing policy of the Government. Nobody can deny that.

Mr. REED. No.

The CHAIRMAN. The expenditures which we make to maintain the Army and the Navy and the Air Force, for example, the expenditures that we make to carry on the Marshall plan, all of these are reflected in the prosperous condition in which business finds itself. But it does seem to me that some of our business leaders seem to think of present prosperous conditions of business as something separate and apart from the necessary Government programs in which we are involved.

Therefore I am trying to get clear in my own mind what is going to happen and what should we do with respect to that coming development if and when we really get into peacetime, if and when it is not necessary for us to spend billions on defense and for war-connected purposes. Then how are we going to maintain this high level and produce through tax revenues the interest that we must pay on the national debt? That is the sort of investment we have got to promote. Do you agree?

Mr. REED. I suspect none of us is wise enough to know the answers to the questions you pose.

The CHAIRMAN. Do you agree with the diagnosis of the situation?

Mr. REED. I am not sure that I understand just the question you are putting to me. What you said I understand, and I quite agree that with Government expending something over $40,000,000,000 it has a very great influence on the level of business activity.

The CHAIRMAN. That is right.

Mr. REED. And the over-all economy of the country. There can be no question about that.

The CHAIRMAN. And unfortunately, if we spend more than we take in, then we have a deficit and that creates new problems.

Mr. REED. That is right.

The CHAIRMAN. And we can balance the budget only by increased taxation upon the one hand, or by reduced expenditures upon the other. And if we reduce expenditures, then we have got to be certain, first, that the reduction of expenditures will not block the over-all objective of the Government, which is to establish a peaceful world; or, secondly, will not prevent the development of our domestic economy so as to maintain the sound basis upon which we may carry on the struggle for the over-all objective.

Mr. REED. I take it you are not suggesting that simply because Government expenditure has reached this very high level in peacetime that we must keep it there because we cannot risk reducing it because of its effect on the economy.

The CHAIRMAN. Not at all.

Mr. REED. We dropped from a $100,000,000,000 rate of expenditure in the war without influencing employment adversely.

The CHAIRMAN. After your agreement with my statement a moment ago with respect to the necessary expenditure situation, I do not believe the phrase "peacetime" correctly describes the conditions under which we are living. We are not in peace. I wish we were. We are in a terrible cold war.

Mr. REED. I accept that correction, sir. I was comparing it with the hot-war period when we were spending $100,000,000,000 a year and came down from that to what was about 35 without causing any unemployment.

The CHAIRMAN. Some people seem to think that blood is cheaper than money; I do not.

Mr. REED. I do not quite know what you mean by that, what you are referring to.

The CHAIRMAN. I am not attributing this to you.

Mr. REED. I hope not.

The CHAIRMAN. Oh, no. But I mean there are people who would balance the budget regardless of its effect upon our drifting into another war.

Mr. REED. I think you know I do not line up with that group.

The CHAIRMAN. Certainly.

Mr. REED. I deeply believe in adequate national defense. How one defines that word "adequate," I do not know.

The CHAIRMAN. That is right.

To get back to the question which is really before us, the evidence to this committee—and I think this is uncontradicted—is that a substantial part of our savings is in institutions. And savings do not move out of those institutions to the small business area, the little and the local business which must be built up, as I see it, if we are to maintain a private economy.

Mr. Griswold told us the other day, for example, that 45 percent of the savings of New England are in trusts, trust companies, insurance institutions, and the like. Forty-five percent of the wealth is being managed for the owners of that wealth. In other words, so far as wealth is concerned, there is a sort of collectivism developing. And that again makes it difficult for the independent, competitive business to get its money.

Now how are we going to get it out of these institutions?—soundly, of course. We do not want to squander it or risk it. But we do want to maintain a climate in which little business can live.

Testimony was presented to us at the outset of the large number of new businesses that were being established—little business, for example. But when those figures were presented no account was taken of the failures, no account was taken of the number of new businesses that have been established as a result of GI loans, for example.

So here we are confronted with the bald question of how to maintain private business on private money without a Government crutch. And if business leadership in the institutions, the banks and insurance companies, and Government leadership, does not find a way to do that, the alternative is perfectly plain, is it not?

Mr. Reed. Yes; I quite agree with you that adequate sources of capital for debt and equity for sound small business undertakings must be made available.

There are, as we have indicated and Mr. Griswold has said, experimental and other steps being taken. But whether insurance companies themselves need statutory help, perhaps, need relaxation, or enlargement of their authority with reference to investment, I do not pretend to know. I am not an expert in that area.

That is why I feel that one of the fine things about this inquiry is that it will look into those matters and will bring to light the problem and a variety of possible solutions of it, essentially to be done by private institutions.

Now if that does not work, then there is another problem to look at. But I think your approach to this problem is dead right and I am very glad these hearings are being held.

The Chairman. Now you told us at the outset that General Electric, because of the problems of reconversion, had to borrow $200,000,000 after the end of the shooting war. But your table also shows that your undistributed earnings as of September 30, 1949, amounted to $388,000,000. So that your figures, taking into consideration the reduction of your borrowings, you had $388,000,000 of undistributed earnings and $170,000,000 of borrowings. The statement did not show what the amount of the sales of stock were. You referred to some profit from the sale of Treasury stock.

Mr. Reed. That is a small item—about 8,000,000. That is not a large item. It is just a technical one that needed to be there.

The Chairman. Yes.

Mr. Reed. The sale of our Treasury stock has on occasion produced a profit which is separately booked, but it is a small item in relation to the total.

The Chairman. You see, as this statement presents your condition, your undistributed earnings are more than twice as much as your borrowed capital. Now the small-business man is not in that position, at all. He cannot finance himself out of the undistributed earnings. And that is a tremendous advantage that the big unit has over the small unit, is it not?

Mr. Reed. Why cannot he finance himself out of undistributed earnings if he is making good profit?

The Chairman. The tax law is one of the explanations, and I think that is true.

Mr. Reed. Surely.

The Chairman. The exemptions are not large enough, from my point of view. The incentives have not been provided because the tax law under which we are operating was devised for the purpose of raising revenue to fight the war.

My personal judgment is that the time has come to revise that tax law for the express purpose of promoting the development of competitive enterprise.

I was interested, Mr. Reed, in your statement with respect to the investments of General Electric abroad and your attitude toward the situation that exists abroad.

Mr. Reed. That is on pages 11 and 12.

The Chairman. On page 14 I find the language that I underlined:

> I believe our Government should make it quite clear that Government funds will not be provided in fields for which private investment and know-how would be available if the proper climate for private investment were created. I further suggest that our Government be not overeager to do favors or grant assistance, even within the clearly governmental field, to countries that are unfriendly toward and discriminate against American private capital.

I recently had the opportunity of discussing the problems of the Marshall plan policy in Europe with Mr. Hoffman. The question of the cartels came about. The objective of ECA is to prevent, so far as possible, the reinstitution of the cartel system in Europe.

Do you regard the cartel system as hostile to private American investment?

Mr. Reed. Yes, I regard it as that. And I also regard it—and I think much more importantly—as a dead hand on the competitive enterprise system as we know it and believe in it in this country.

I think it is one of the great problems of not only western Europe but pretty much all the world except the United States and perhaps Canada—this basic philosophical difference between our conception of the importance of competition as a regulator and stimulator of economic activity and the foreign view about it, which takes a much lesser degree of competition and is quite happy with it.

The Chairman. And you agree that Government policy should be directed toward the maintenance of competition?

Mr. Reed. I do, indeed, sir.

The Chairman. Good.

Several years ago I introduced a bill, the purpose of which was to protect free enterprise against further development of the cartel system. This was a mild bill. It provided only that corporations doing business in the United States and abroad, also, should file with an appropriate Government agency complete information with respect to any contracts into which they might enter with foreign governments or foreign corporations by which trade territories should be divided, by which production should be controlled, or by which prices should be fixed.

I am not going to ask you here to express an opinion about that, because we did not bring you here to go into an antitrust investigation, but merely to discuss the problems of investment.

Mr. REED. Let me just say this one thing on that subject: That is that the contracts, the arrangements that General Electric Co. has made which have been the subject of litigation between the Government and General Electric Co. in every case were done quite openly; the contracts were available to and well known to the Department of Justice for years before the litigation was brought.

So I think from the standpoint of General Electric Co. the recording of our conduct as expressed in these various agreements which were later attacked—with the law and its interpretation changing, as we all agree it has, during the past 25 years—and held to be illegal, would not have prevented what happened. In our case at least. In other cases it might be quite different.

The CHAIRMAN. I did not direct my bill specifically against General Electric. It is the general principle I was concerned about.

Mr. REED. Right.

The CHAIRMAN. But we do agree that the cartel system is hostile to the American way of life?

Mr. REED. We agree most heartily and sincerely on that one.

The CHAIRMAN. I hope we can cooperate and get some specific results along that line to protect the American way.

I have one or two more questions.

Mr. KREPS. Mr. Chairman, may I ask a question along this line?

The CHAIRMAN. Yes, indeed.

Mr. KREPS. I can quite understand your reasoning that because of the size and diversity of the company a number of the questions you did not answer were inapplicable. And, of course, I share the view that the Government should know more and more and be able to disseminate such information.

Among the questions you omitted was one along the line the chairman is discussing now. It is question VIII, which asks, "What is the minimum investment required to start a new enterprise in your industry? In your opinion what would be the principal obstacles such an enterprise would have to face?"

The Department of Commerce has provided information for a number of industries on the amount of capital required in each in order to start. In their list of businesses are those in which there was more or less unobstructed access, or free entry, or free enterprise.

I regret to say that in that list, which I will be glad to submit for the record, Mr. Chairman, if you would like to have it, the various types of electrical industries are not included.

The CHAIRMAN. It will be accepted for the record.

(The list referred to is as follows:)

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November 23, 1949

Commerce Department Estimates on Amounts of Capital Needed to Start Certain Businesses

Note.—The data for this table are obtained from 35 manuals on establishing and operating small businesses in the Industrial (Small Business) Series issued by the United States Department of Commerce during 1945 and 1946. The figures in almost all cases are illustrative and subject to numerous individual qualifications. This is evident in many cases from the range indicated. It should be borne in mind that the substantial price increases which have occurred since 1945 and 1946, the publication dates of these manuals, would indicate that the figures given may in many cases be understated to a substantial degree. On the other hand, there may be frequent individual cases where a successful business may be started on even smaller amounts of initial capital than are indicated here. Being well known in a community, having unusual skills, acumen, or even good luck, or benefiting from unexpected economic developments in the community may make it possible for a limited number of persons to start businesses with less capital than the amounts given below. However, the manuals generally agree that lack of adequate capital is often an important factor in the failure of many new businesses, and that it is much more difficult to establish a successful business with a minimum of capital than when a more adequate margin of capital is available.

Type of establishment	Suggested minimum capital requirements for starting
Air conditioning and refrigeration business	One-fifth of gross sales or $5,000 to $6,000.
Apparel store (specialty)	$8,245 to $15,470.
Automatic merchandising business	$5,000.
Automobile repair business	Overhead expenses for 3 months plus $500.
Book store	$4,900 to $5,100.
Bookkeeping service	$500 to $1,000.
Concrete block plant	$27,000 to $200,000.
Confectionery-tobacco store	$1,000 plus.
Dry cleaning business	$5,000.
Gift and art shop	$4,000.
Grocery store	$4,000 (average estimate).
Hardware store	$5,000.
Heating and plumbing contracting business	6 months' rent, automobile, tools and $500.
Jewelry store	$5,000 to $15,000.
Laundry	$15,000.
Mail-order business	$100 to $500.
Music store	$3,000 to $10,000.
Paint, glass, and wallpaper store	$5,000 to $8,000.
Painting and decorating contracting business	$1,000.
Real estate and insurance brokerage business	$500 to $1,000.
Restaurant	$5,000 to $6,000.
Retail bakery	$5,000.
Retail feed and farm supply store	$2,500 to $10,000.
Retail shoe store	$4,500 to $8,500.
Service station (for leased station)	$2,670 to $5,600.
Shoe repair business	$850.
Small print shop	$12,000.
Small sawmill business	$6,398.
Small woodworking shop	$1,000 to $2,000.
Sporting goods store	$10.000.
Stationery and office-supply store	$5,400.
Trucking business	$2,000 to $3,000 plus equity in truck.
Variety and general merchandise store	$5,000 to $10,000.
Weekly newspaper	$10,000 to $15,000.
Year-round motor court	$16,000 (cost of 10 rooms).

Mr. Kreps. Not only is the electrical industry not included, but there is no understanding as yet of what the obstacles might be to free entry of a new company. I may say that popularly the cartel system is often regarded as an obstacle that might have existed or, perhaps, might still exist.

Mr. REED. Are you speaking about the American electrical industry, sir?

Mr. KREPS. Yes. I noticed that you did not answer that question.

Mr. REED. Let me tell you the answer to it; I thought it was quite obvious. It takes one kind of money, one amount of money, to go into the business of making an electric toaster, and another kind to provide the capital to build steam turbine generators. Those are just two rather extreme examples.

But there is every degree of variation between those two extremes. And it just seemed to me perfectly evident with General Electric Co., and speaking for General Electric Co., the question is unanswerable, except as one put down a list of hundreds of different products and assumed the company was going into that one; or if you want to assume the company was going to go into a group of them, it would again take another amount of money. It is just not applicable to our company. I do not see what that has to do with cartels of which you made some mention.

Mr. KREPS. Sometimes the cartel system has operated to make it difficult for a new firm to start.

For instance, if a man with a new idea in the electrical field wanted to start and survive, is the industry of such variety that he could, say, survive making only electric toasters or electric lamps?

Mr. REED. Surely. There are companies in the industry making electric toasters. Toastmaster Co. makes nothing but electric toasters as far as I know and does very well indeed. There are many companies making single lines of products and succeeding excellently, and in cases having a substantially higher percentage of the business than General Electric does within that product line.

The CHAIRMAN. You spoke of some 208 company names on a list of subcontractors of General Electric?

Mr. REED. Yes, sir.

The CHAIRMAN. How many of those companies are exclusively working on General Electric subcontracts?

In other words, what I am trying to determine is what proportion of them are operating in several fields and what proportion are definitely attached to your supply, your product.

Mr. REED. For this particular product, this turbojet engine?

The CHAIRMAN. No.

Mr. REED. That particular case was of one product.

The CHAIRMAN. Then let's discuss that first.

Mr. REED. The turbojet, in which we had 208—I have forgotten what page that was on.

The CHAIRMAN. Page 4. In the second paragraph you spoke there of 2,500 subcontractors.

Mr. REED. Yes.

The CHAIRMAN. That is the general figure?

Mr. REED. That is right. And you question is: Are there any of those who are exclusively engaged in making parts or components for General Electric Co.?

The CHAIRMAN. For General Electric and no other prime contractors.

Mr. REED. I would have to check. My impression is that there are none. If there are any, it is a very small number. And I will, if you are interested, inquire of our purchasing department whether there are any of these suppliers who are supplying exclusively to General Electric.

Incidentally, Senator, the 2,500 subcontractors were under United States Government war contracts. A little later, in the next paragraph, you will see there are 31,000—in the final paragraph on the page—suppliers to us of parts, components, and materials—a very large number.

The CHAIRMAN. Suppose you do let us know if any of those 31,000, and if so how many, deal exclusively with General Electric.

(The information requested by Mr. Reed has been supplied as follows:)

I am informed by our purchasing department that they know of no outside supplier who serves General Electric Co. exclusively.

Now with respect to your patent-licensing system, described on the next page, you have today outstanding 638 separate license agreements under more than 3,500 patents covering a wide variety of products. And you are listing with the Patent Office 2,300 patents which it will be your policy to make available to any applicant on a reasonable royalty basis.

Does that policy apply to all patents which you are not yourselves using?

Mr. REED. You mean the policy of listing in the Patent Office Register?

The CHAIRMAN. And of being willing to license at a reasonable royalty.

Mr. REED. As the final sentence of that paragraph indicates:

It is our policy to grant licenses to any applicant on a reasonable royalty basis under all patents which we are not now using or which we have no plans for using within a reasonable period.

That does not mean that those patents would necessarily, at this stage at least, be recorded with the Patent Office on an official publication basis, which is what happens when they list them in their register for licensing at any time to anybody, any applicant at a reasonable royalty.

I put that last sentence in to give breadth to the generality of our policy of being willing to license anyone on a reasonable royalty basis with reference to any patent that we are not currently using and do not have plans in the immediate future to use.

The CHAIRMAN. In other words, you are excluding from this licensing policy only those patents which you are yourselves definitely using or which you plan to use?

Mr. REED. We are not excluding all of those, because on a great many that we are using we also have granted licenses and do grant licenses to others. In other words, the fact that we are using a patent does not draw the line against licensing others.

The CHAIRMAN. And can you describe the considerations that enter into the determination of what a reasonable royalty is? Does it have anything to do with the price at which the product is sold?

Mr. Reed. Well, these licenses are very frequently not on the entire finished product as sold. Very often they are on some part. And there cannot be a fixed formula for determining what an appropriate royalty is.

The royalty that we charge is over-all small with reference to the value of the patented element. It is between 2 and 3 percent; something of that order. It is a small royalty.

The Chairman. You speak of having some 200,000 distributors.

Mr. Reed. Dealers.

The Chairman. Dealers; yes. Are they your own dealers or independent dealers, independent merchants?

Mr. Reed. They are independent merchants.

The Chairman. Independent merchants?

Mr. Reed. Yes, sir.

The Chairman. Does the contract with those independent merchants contain provisions for resale prices?

Mr. Reed. In the first place, in almost all cases we do not have direct contact with the dealer. We sell to a jobber or distributor, as we call them, or wholesaler. And he in turn serves the dealer. Now there are certain exceptions depending on the character of the product, but generally speaking that is true.

We do in some categories have goods which have a retail-price-maintenance requirement under the law. I do not know what percentage of our product we do that on, but it is very small.

The Chairman. Then you want the committee to understand that in your relationship with the suppliers, and in relationship with the distributors, you are promoting a free economy?

Mr. Reed. Yes, indeed, we are.

The Chairman. That is the policy of General Electric?

Mr. Reed. Yes, sir; it is indeed.

The Chairman. You spoke about having retained about 23 or 24 percent of the electrical industry.

> The electrical industry—

you tell us—

> started in the closing decades of the last century as a small industry. It grew rapidly in importance, and because of the nature of its product and the service which this product renders to users, it has come to occupy a key place in a modern economy.

Then later on you told us that General Electric has just about kept pace with the expansion of the electrical industry in the country at large.

You grew at some period until you accounted for 23 or 24 percent of the total product. And then in recent years you have not been able to gain more than 23 or 24 percent. That is the picture; is it not?

Mr. Reed. That is our position, yes, and has been for 20 or 30 years.

The Chairman. I was very much interested in the statement that was issued by the Secretary of Commerce on the 1st of this month in a letter to Chairman Celler of the House Judiciary Committee in which he submitted a list of tables showing the concentration of output in largest manufacturing companies—industries arrayed in order of value of shipments.

When I read your paper, I turned to this to find if the electrical industry, that is to say, the product of General Electric, was listed anywhere under a separate head. And it seems to me that is not the case in this listing, but that the products which you manufacture are separately described.

For example, here is refrigeration machinery. General Electric manufactures refrigeration machinery. Here is heating and cooking apparatus. That is another item. Motors and generators is another.

Those three are in the $1,000,000,000 and above category.

Then in the next category, 500 million to a billion—that is in order of value of shipments—electrical control apparatus.

And then in the 100 to 500 million, electrical appliances and transformers.

Now all of these are manufactured by General Electric; are they not?

Mr. REED. Yes.

The CHAIRMAN. According to the Secretary's table—perhaps I should say the table of the Bureau of the Census—the four largest companies in 1947 manufactured 39.1 percent of all refrigeration machinery. No comparable figure is given for 1935; for some reason or another it was not available. The first four companies are set at 39.1 The first eight companies have 54.5.

With respect to heating and cooking apparatus, the first four had 11.7; the first eight had 20.2. Again there is no comparable figure for 1935.

With respect to motors and generators, the first four companies had 58.6; the first eight had 66 percent. And again no comparable figure.

With respect to electrical control apparatus, the first four had 49 percent; the first eight had 63.2 percent. Again there was no comparable figure for 1935.

Electrical appliances: The first four companies had 35.8; the first eight had 46.9.

And with respect to transformers, the first four had 72.9; the first eight had 84.3. And again there was no comparable figure.

Have you any idea of what the comparble figure would be for 12 years ago?

Mr. REED. I would not have any idea specifically to fill in those blanks without having studies made. I do not understand why they have not been filled in unless the data just were not available for that period.

The CHAIRMAN. Apparently they were not available.

Mr. REED. I have not seen the schedule you are referring to. I will get one.

The CHAIRMAN. It is very interesting because it gives additional information.

For example, there were 542 companies manufacturing refrigeration machinery; 792 turning out heating and cooking apparatus; 224 manufacturing motors and motor generators; 284, electrical control apparatus; 310, electrical appliances; and 134, transformers.

There was another category, engine electrical equipment, of which there are 100 companies; the first four turning out 66.8, and the first eight, 81 percent.

Electric lamps, 35 companies; the first four manufacturing 91.8 percent; the first eight, 96.3 percent.

Electrical industry apparatus—this is less than 100 million—191 companies; the first four, 33.7; the first eight, 49.8.

That seems to me to represent a very high degree of concentration.

Mr. REED. If I were to have to guess at it, I would be glad to make a small wager with you, Senator, that the corresponding figures for 10 years ago, and 10 years ago before that, would show a higher concentration than these latest figures do. In other words, I think the trend is away from rather than toward.

The CHAIRMAN. Let's get the conclusion of the Department with respect to that very point.

Mr. REED. I am speaking of the electrical industry now.

The CHAIRMAN. Oh, yes.

Mr. REED. I do not know about the others, but I would have a hunch they would be, in general, the same.

The CHAIRMAN. There was a summary table, table V, "Changes in Concentration Ratios, 1947 Compared with 1935."

I will put that in the record. The source is the Census of Manufacturers.

The explanatory comment on the table reads as follows:

> This table summarizes the changes which may be observed in concentration ratios between 1935 and 1947 for those industries for which the data permit direct comparison. Such comparisons can be made for the first four companies in 130 of the 452 industries while comparisons are possible for the first 8 companies in 133 of the industries. Lack of comparability in other cases is due to differences in industry classfication in the two censuses. In terms of numbers of industries alone without regard to their size or importance, the data show a somewhat larger number of decreases than increases. Inspection of table I shows that in the industries over $500,000,000 there are somewhat more increases than decreases, while the reverse is true for industries under $500,000,000.

(The table is as follows:)

TABLE V.—*Changes in concentration ratios, 1947 compared with 1935*

Amount of change (percent)	Increases		Decreases	
	First 4 companies	First 8 companies	First 4 companies	First 8 companies
Less than 1	5	10	8	8
1 to 1.9	6	2	9	4
2 to 2.9	8	6	5	3
3 to 3.9	5	6	5	12
4 to 4.9	8	7	8	6
5 to 9.9	17	15	10	15
10 to 14.9	4	6	11	12
15 to 19.9	1	3	11	11
20 to 24.9	2	1	4	3
25 and over	2	1	1	2
Total	58	57	72	76

Source: Census of Manufactures, 1947 and 1935.

The CHAIRMAN. In other words, these statistics are interpreted by the Bureau of the Census as showing that in the very large industries—in which, of course, the electrical business falls, the rate of increased concentration is growing, whereas in those in which the output of the whole industry in each case is less than $500,000,000 the reverse was true.

Mr. REED. I am wondering whether the electrical industry does, as classified there, generally fall into the large group; does it? Do they not break it down into lines?

The CHAIRMAN. Yes. It was broken up, as indicated at the outset, into different categories.

Mr. REED. They are still referring to those categories in that summary, are they not?

The CHAIRMAN. Yes.

Mr. REED. And there are some in the large and some in the intermediate, and some in the smaller.

The CHAIRMAN. Yes; but with respect to General Electric, it is listed in several of these categories.

Mr. REED. Right.

The CHAIRMAN. But nevertheless General Electric itself represents a concentration which does not appear here at all.

Mr. REED. That is right.

Mr. KREPS. I have some figures bearing on that same problem, Mr. Chairman.

The CHAIRMAN. All right.

Mr. KREPS. In Moody's Manual of Investments, there are reports of changes in the net property, plant, and equipment of scores of companies including the General Electric Co.

The figures show, for example, that General Electric's accounts are carried at $132,000,000 in 1946 and by 1948 had grown to $259,000,000.

Mr. REED. That is our net plant.

Mr. KREPS. That is right, your net plant.

Mr. REED. After the depreciation.

Mr. KREPS. Including property and equipment. Of course, that is not altogether an accurate measure. I imagine that in some ways this understates the real increases, possibly.

Mr. REED. In the late 1930's it was written down to about 4 millions.

Mr. KREPS. That is right, because reserves for depreciation and depletion are subtracted and so on.

Mr. REED. That is right.

Mr. KREPS. So with those limitations—and they exist all the way around—the interesting fact appears that in that relatively short period you nearly doubled your investment. I want to ask a little later what the incentives were. I judge the answer is relatively simple —there was a vigorous consumer demand.

But the problem that the chairman was raising is of interest.

In similar fashion there has been compiled by experts in the Legislative Reference Service a table showing the net additions, property, plant, and equipment, that have occurred from the first quarter of 1947 through the first quarter of 1949, classified by asset size; that is, corporations with assets under $250,000, those with asests from $250,000 to $1,000,000; those with assets of a million to 5 million; those with assets of 5 million to 100 million; and those with assets of 100 million and over.

Now, of course, General Electric comes in the category of companies with assets of 100 million or over.

It is interesting that in this group as reported by the quarterly industrial financial report series for all United States manufacturing corporations, compiled by the Federal Trade Commission and the Securities and Exchange Commission, the total amount of additions to plant and property and equipment in that period was 11 billions, roughly—$11,003,000,000—of which 7 billion and 57 million occurred in the plants of corporations with reported assets of 100 million and over; and that in plants with less than 1 million in assets only 425 million was reported, with net decreases, of course, in that category in the first quarter of 1949.

The CHAIRMAN. That is from Moody?

Mr. KREPS. Yes; Moody's Manual and from the quarterly reports put out by the Federal Trade Commission and the Securities and Exchange Commission.

Mr. REED. Does that pick up the listed securities only?

Mr. KREPS. Many of the companies; yes. It is a compilation of the data reported by each company.

Mr. REED. Listing those listed on some stock exchange.

Mr. KREPS. Most of them, no doubt, but the reports are those compiled by Moody's to whom each company makes its own reports.

Mr. REED. So these are not that great broad band of small- and medium-sized businesses not large enough to have been traded upon in the exchanges of the country.

Mr. KREPS. There no doubt are many which do not make such reports.

Mr. REED. Right.

Mr. KREPS. The group, therefore, is not quite the same as the group of corporations that have stocks on the stock markets.

The percentage increase in reported estimated value of property, plant, and equipment in the year 1948 over 1947, for example, in the group under $250,000 is 7.4 percent. In the group $100,000,000 and over, it is 21.9 percent.

Mr. REED. Of the net plant at the beginning of the period?

Mr. KREPS. That is right. And the other figures graduate upward from 7.4 to 21.9.

It is interesting that in 1949 over 1948 the group that reported a net decrease was the group under $250,000.

The group that reported the largest increase, again, is this group over $100,000,000, reporting 22.2 percent increase.

The CHAIRMAN. May I add at that point, that the evidence before the committee would seem to indicate that the savings through life-insurance companies were channeled primarily into those larger companies.

Mr. KREPS. Yes. These tables substantiate the observations that the chairman made a moment ago. The evidence indicates, first of all, that the problem of stabilization of plant and equipment and investment expenditure is in a very substantial degree a problem of the larger corporations, that is, corporations of 100 million and over. After all, they account for 7 billions out of 11 billions in corporations of 100 million and over. If we could get a stabilization of investment expenditures in those firms, it would substantially help the economy. We would lick a substantial part of the problem, though not all of it.

It also indicates that even in this past period of rather rapid expansion small business did not participate, at least during 1948.

Mr. REED. I wonder honestly whether you can draw that conclusion from a study of Moody's.

Mr. KREPS. I do not draw the conclusion; I said the evidence so indicates.

Mr. REED. Because you have not got a very large part of the base in there. You have all the big ones because they all would be listed. But you have, I think, only a small fraction of the smaller ones.

Mr. KREPS. Of course, you do not need to bail out the ocean in order to know what ocean water is like. A sample is all you need.

Mr. REED. You have to have a sample that is a cross section.

Mr. KREPS. The sample is a cross section.

Mr. REED. You have all the big and only a small part of the medium and small.

Mr. KREPS. The Securities and Exchange Commission and the Federal Trade Commission both have been careful to make sure that the sample they have of the corporations with less than $250,000 assets is statistically reliable, as reliable as we can make it.

But you are quite right that the sample by no means includes all of them, whereas, obviously, it is a simple matter to get the reports for every firm over 100 million.

Mr. REED. I did not understand the data were supposed to be a sample, but simply a listing of all they had available of these various categories. And we both agreed a great many of the small and medium companies are not listed on any stock exchange or do not make any reports, and, therefore, there is a gap there; whereas none of the over 100 million, with the possible exception of Henry Ford, and even his data are available through SEC.

Mr. KREPS. That is true.

We have no basis for believing that those small corporations upon which we do not have evidence in any way deviate in their behavior or problems or experience from those upon whom we do have evidence.

The CHAIRMAN. That data may be put in the record.

(The data referred to is as follows:)

TABLE I.—*Estimated value of property, plant, and equipment (net) for all manufacturing corporations, by size of assets, first quarter 1947 to second quarter 1949*

[Millions of dollars]

Asset size	1947				1948				1949	
	First quarter	Second quarter	Third quarter	Fourth quarter	First quarter	Second quarter	Third quarter	Fourth quarter	First quarter	Second quarter
Under $250,000	774	812	822	815	831	852	856	866	809	838
$250,000 to $999,000	1,556	1,618	1,654	1,696	1,771	1,833	1,895	1,924	1,916	1,917
$1,000,000 to $4,999,000	3,252	3,413	3,490	3,638	3,639	3,778	3,878	4,032	3,758	3,842
$5,000,000 to $99,999,000	8,468	8,868	9,310	10,079	9,971	10,386	10,760	11,201	11,511	11,732
$100,000,000 and over	14,447	15,166	15,769	16,093	17,604	18,929	19,518	20,870	21,504	21,602
Total for all	28,496	29,877	31,045	32,321	33,816	35,778	36,907	38,894	39,499	39,931

NOTE.—Columns will not necessarily add to totals because of rounding.

Source: Quarterly Industrial Financial Report Series, for all United States Manufacturing Corporations, Federal Trade Commission and Securities and Exchange Commission.

TABLE II.—*Estimated changes in property, plant, and equipment (net) for all manufacturing corporations, by size of assets, first quarter 1947 to second quarter 1949*

[NOTE.—Balance sheet figures do not give an accurate measure of the amounts spent for new plant and equipment. In addition to this, these figures understate increases in plant and equipment since reserves for depreciation and depletion are subtracted. Estimates of actual expenditures on new plant and equipment by United States business are made quarterly by Securities and Exchange Commission and Department of Commerce but no break-down by asset size is made. Columns will not necessarily add to totals because of rounding.]

[Millions of dollars]

Asset size	1947			1948				1949	
	Second quarter over first	Third quarter over second	Fourth quarter over third	First quarter over fourth	Second quarter over first	Third quarter over second	Fourth quarter over third	First quarter over fourth	Second quarter over first
Under $250,000	38	10	−7	16	21	4	10	−57	29
$250,000 to $999,000	62	36	42	75	62	62	29	−8	1
$1,000,000 to $4,999,000	161	77	148	1	139	100	154	−274	84
$5,000,000 to $99,999,000	400	442	769	−108	415	374	441	310	221
$100,000,000 and over	719	603	324	1, 511	1, 325	589	1, 352	634	98
Total for all	1, 381	1, 168	1, 276	1, 495	1, 962	1, 129	1, 987	605	432

Source: Quarterly Industrial Financial Report Series for all United States Manufacturing Corporations, Federal Trade Commission, and Securities and Exchange Commission.

TABLE III.—*Estimated increase in property, plant, and equipment (net) for all manufacturing corporations, by size of assets, 1948 over 1947, and 1949 over 1948, as of Mar. 31 of each year*

[NOTE.—Balance sheet figures do not give an accurate measure of the amounts spent for new plant and equipment. In addition to this, these figures understate increases in plant and equipment since reserves for depreciation and depletion are subtracted. Estimates of actual expenditures on new plant and equipment by United States business are made quarterly by Securities and Exchange Commission and Department of Commerce but no break-down by asset size is made. Columns will not necessarily add to totals because of rounding]

[Millions of dollars]

Asset size	Mar. 31, 1947, to Mar. 31, 1948	Mar. 31, 1948, to Mar. 31, 1949	Percent increase	
			1948 over 1947	1949 over 1948
Under $250,000	57	−22	7. 4	−2. 7
$250,000 to $999,000	215	145	13. 8	8. 2
$1,000,000 to $4,999,000	387	119	11. 9	3. 3
$5,000,000 to $99,999,000	1, 503	1, 540	17. 7	15. 4
$100,000,000 and over	3, 157	3, 900	21. 9	22. 2
Total for all	5, 320	5, 683	18. 7	16. 8

Source: Quarterly Industrial Financial Report Series, for all United States Manufacturing Corporations Federal Trade Commission and Securities and Exchange Commission.

TABLE IV.—*Value of property, plant, and equipment (net) for 27 manufacturing corporations having over $500,000,000 in assets, 1946, 1947, and 1948*

[All figures in millions of dollars]

Company (ranked asset size)	Assets 1948	Property, plant, and equipment (net)				
		1946	1947	Increase 1947 over 1946	1948	Increase 1948 over 1947
Standard Oil Co. (New Jersey)	3, 439	1, 278	1, 526	248	1, 860	334
General Motors Corp	2, 958	608	723	115	775	52
United States Steel Corp	2, 535	827	940	113	1, 301	361
Standard Oil Co. (Indiana)	1, 500	637	798	161	976	178
Socony-Vacuum Oil Co., Inc	1, 443	578	638	60	733	95
Texas Co	1, 277	414	487	73	622	135
Gulf Oil Corp	1, 191	482	574	92	659	85

Table IV.—*Value of property, plant, and employment (net) for 27 manufacturing corporations having $500,000,000 in assets, 1946, 1947, and 1948*—Con.

[All figures in millions of dollars]

Company (ranked asset size)	Assets 1948	Property, plant, and equipment (net)				
		1946	1947	Increase 1947 over 1946	1948	Increase 1948 over 1947
E. I. du Pont de Nemours & Co	1,189	284	341	57	413	72
General Electric Co	1,177	132	207	75	259	52
Ford Motor Co	1,149	296	386	90	431	45
Standard Oil Co. of California	1,075	520	606	86	690	84
Bethlehem Steel Corp	1,029	376	441	65	495	54
Subtotal, companies having assets over $1,000,000,000		6,432	7,667	1,235	9,214	1,547
Cities Service Co	992	552	610	58	653	43
Union Carbide and Carbon Corp	723	151	238	87	330	92
Sinclair Oil Corp	710	242	298	56	387	89
Westinghouse Electric Corp	694	105	133	28	157	24
American Tobacco Co	687	23	33	10	42	9
International Harvester Co	672	157	206	49	245	39
Anaconda Copper Mining Co	660	353	354	1	358	4
Western Electric Co., Inc.[1]	650	73	79	6	164	85
Shell Union Oil Corp	641	192	277	85	334	57
Phillips Petroleum Corp	579	235	290	55	391	101
Kennecott Copper Corp	575	194	201	7	206	5
Chrysler Corp	541	85	104	19	150	46
R. J. Reynolds Tobacco Co	531	19	25	6	30	5
Swift and Co	523	100	121	21	140	19
Aluminum Co. of America	504	144	210	66	271	61
Subtotal, companies having assets from $500,000,000 to $1,000,000,000		2,625	3,179	554	3,858	679
Grand total, 27 companies		9,057	10,846	1,789	13,072	2,226

[1] Manufacturing subsidiary of the American Telephone & Telegraph Co.

Source; Moody's Manual of Investments, Industrial Securities, 1949; Moody's Manual of Investments, Public Utility Securities, 1949.

The Chairman. Are there any other questions?

Let me conclude with this comment, Mr. Reed.

It seems to me that the evidence before us indicates rather plainly that the big unit, because of its stability, its maturity, its earning power, is able to defend itself much more successfully against the cyclical changes of the economy and that the little fellows are not; that the position of the little fellows is made more delicate because of the lack of access to the savings of the people.

The figures also make it clear that because of the high rate of industrial production during and since the war, the high rate of employment, the increased wages, and increased profits, the savings of the people in the lower income groups, say, those who have reported net incomes of $10,000 and less, constitute by far the great bulk of the savings available for investment as well as they constitute the great bulk of the purchasing power of the public.

Our problem is to find ways and means of channeling at least a portion of those savings into sound local competitive enterprise. If we do not do that, then the major industries will continue to concentrate and the demand for Government participation in industry in various ways will continue to grow.

That, it seems to me, is our problem.

We are very grateful to you, Mr. Reed.

Mr. Reed. Thank you very much, again.

The CHAIRMAN. We will reassemble at 2:30 and, Mr. Scoll, who is the witness?

Mr. SCOLL. The witnesses will be Hardwick Stires, representing the Association of Investment Trust Companies, and Mr. Sidney L. Sholley, representing Keystone Custodian Funds. This afternoon's hearing will be devoted to the investment trust companies.

The CHAIRMAN. The committee will stand in recess until 2:30.

(Whereupon, at 12:30 p. m., the committee recessed, to reconvene at 2:30 p. m., on the same day.)

AFTERNOON SESSION

The CHAIRMAN. The committee will be in order.

Mr. Stires, the committee will be very glad to have your statement now, if you please.

STATEMENT OF HARDWICK STIRES, REPRESENTING THE NATIONAL ASSOCIATION OF INVESTMENT COMPANIES

Mr. STIRES. Mr. Chairman, members of the subcommittee, ladies, and gentlemen, my name is Hardwick Stires. I represent the National Association of Investment Companies. In the association I am a member of its three-man administrative committee, and a member of its larger executive committee. I am also an officer and director of the Scudder, Stevens & Clark Fund, Inc., one of the member companies of the association.

I appear at this hearing not to express opinions—unless asked for them—nor to draw conclusions, and not to ask this committee for special legislation. I am here in an attempt to present to you a concise statement of what our business is, what it does, whom it serves, and to submit factual data from which you may draw your own conclusions regarding our present and potential contribution to the economy.

The National Association of Investment Companies comprises 130 investment companies—ranging in size from $260,000,000 to less than $1,000,000 of net assets. In the aggregate these 130 member companies administer and manage a total of more than $2,500,000,000 of assets. All of these companies are registered with the Securities and Exchange Commission as management investment companies as defined by the Investment Company Act of 1940.

A RELATIVELY NEW VEHICLE

The investment company may be known to some of you under its formerly more familiar designation of investment trust. The investment trust or investment company as such is relatively new in this country. It had its origins on the Continent of Europe and was more fully developed in Great Britain during the past (the nineteenth) century. The basic idea though is essentially the same—that is, to bring together the funds of investors, large and small, in aggregate shares of beneficial interest that they might have the advantage of diversification and investment management not always available to the investor of modest means.

In comparison with the total of funds in the care of insurance companies, savings banks, and trust companies of this country, the total under the supervision of investment companies is relatively small. However, for the purposes of this inquiry they have an appropriate place because of their high equity content and because of the factor of their current growth trend.

The roster of investment companies registered with the Securities and Exchange Commission includes names other than the 130 companies which I represent. The reason for this primarily is that a number of companies are not publicly owned, or they may be regarded as engaged in another type of business such as a mining or industrial enterprise. However, most investment companies have a common characteristic through spreading the ownership of the equity portion of American industry among the people—mostly among small investors—and through providing a means of minimizing the risk invariably present in all investment by spreading the risk through diversification and supervision of the portfolio securities.

TWO TYPES—OPEN-END, CLOSED-END

In general, investment companies are of two types—open-end and closed-end. The open-end and closed-end companies are essentially similar both in respect of their investment operations and their public ownership. The difference lies in their capital structures. In the case of the closed-end companies the capital structures are relatively fixed. The open-end companies, however, for the most part are constantly issuing new shares to the public and they are required by Federal law to redeem their shares on demand from any holder. In each of the last 9 years new shares issued have exceeded redemptions, and thus the open-end companies have grown and their total assets now exceed those of the closed-end companies. During the same period and for some years prior thereto, the closed-end companies rarely attempted to obtain any new capital.

Except in one or two instances, the open-end companies have issued only one class of security—common stock. This is also true of a number of closed-end companies, but some of the latter include preferred stock, debentures or bank loans in their capital structures.

A GROWING INVESTMENT DEVELOPMENT

In less than 9 years, from December 31, 1940, to September 30, 1949, the total net assets of 87 open-end companies increased from $448,000,000 to $1,755,000,000, or almost 300 percent, and based on the current rate of sales and market conditions, it is estimated that their assets have by now more than quadrupled. This was due both to raising new capital and to the increase in value of their portfolio investments. During the same period 39 closed-end companies retired (net) more than $200,000,000 of their own capital, mostly debt or preferred stock, but despite that fact their assets have increased by more than $100,000,000.

The CHAIRMAN. This is sort of a golden era for investment companies?

Mr. STIRES. Yes; that is a relatively small increase compared to their total assets, though.

The CHAIRMAN. Oh, yes; that is quite true. But when you consider this has all transpired in less than 9 years, it is a marvelous story of growth.

Mr. STIRES. It is, indeed, percentage-wise.

During the same period of less than 9 years, the 87 open-end companies issued new shares valued at $1,875,000,000—after deducting all selling charges—and redeemed shares valued at $729,000,000—thus raising new capital (net) of $1,146,000,000. For the first 9 months of 1949, sales of new shares continued at an accelerated pace, at an annual rate of almost $350,000,000 (gross) or more than $260,000,000 net, after redemptions.

INVESTMENTS IN EQUITY SECURITIES

There are many types of investment companies classified roughly according to investment policy and the objectives or needs of their shareholders. Among these companies there is a wide choice of shares available to meet investor objectives with respect to income needs, relative safety of principal, or opportunity for capital appreciation— or even participation in venture capital enterprises at relatively greater risk. However, of the funds available to investment companies the bulk has been and is being invested in equity securities, primarily common stocks, usually in a diversified list comprising many, perhaps 30 to 100, issues in a number of different industries.

A recent survey covering 75 open-end investment companies having total assets of more than $1,500,000,000 on June 30, 1949, indicates that 86 percent (in value) of their investments were in stocks rather than bonds. More than 90 percent of total investments were in securities listed or traded on the New York Stock or Curb Exchange.

The same survey indicates that during the three years, 1946–48, only 31 percent of the new capital raised by these companies came from the States along the north Atlantic seaboard. By coincidence, the origin of business on the New York Stock Exchange is almost exactly the reverse, or 69 percent from the north Atlantic seaboard and 31 percent from all other areas. More than 81 percent of sales of open-end shares were made by nonmembers of the New York Stock Exchange. These figures indicate that the shares of investment companies are owned in large part by many new equity investors who have not purchased securities on the New York Stock Exchange.

I think maybe that could be amended a little bit to read "who do not habitually purchase securities on the New York Stock Exchange."

As a group investment companies are today one of the largest holders of common stocks of this country's industrial corporations. Yet, a survey just completed indicates that almost complete absence of control by investment companies of the corporations in which they invest. Ninety-six investment companies (68 open-end and 28 closed-end), having total assets of $2,300,000,000, reported total investments of $83,000,000 (only 3.6 percent of their assets) in corporations of which they owned more than 5 percent of voting securities, of which only $45,000,000—less than 2 percent—was invested in securities representing more than 25 percent of voting power. The 68 open-end companies reported no holdings representing more than 25 percent of voting power, and only $13,000,000—less than 1 percent of assets—in investments representing more than 5 percent of voting power.

READY MARKETABILITY

Open-end investment companies, because of the necessity that they remain relatively liquid as to the marketability of their portfolio, and because they are prohibited from doing so by the blue-sky regulations of certain States, are unable, except to a limited extent, to take a direct participation in venture capital enterprises. Rather, their function is to spread the beneficial ownership of the outstanding equities of established companies among a constantly widening circle of small stockholders who, in many cases, have not hitherto owned equity investments.

The closed-end type of investment company—whose securities are not subject to redemption by their stockholders on demand—enjoy much greater freedom of investment policy in this respect, and have, in fact, made some contribution to the supply of enterprise capital. A number of closed-end investment companies have been designed for the specific purpose of participating in general or specialized investments of this character. For example, the American Research & Development Corp., the Newmont Mining Corp., and the International Mining Corp. come to mind as active in this respect. The Chicago Corp. found the natural gas industry and related fields so attractive that, over a period of years, it concentrated such a large proportion of its assets in this type of investment that it eventually ceased to be an investment company and went over to the actual management of oil and natural gas enterprises.

Further, certain large holding companies, as a result of divestments under the Public Utility Holding Company Act, have signified their intention of asking the assent of their stockholders to their becoming investment companies for special or general purposes. Also, there have been numerous instances of investments in development situations by the large diversified closed-end investment companies. The closed-end investment company has demonstrated that there is no question that it is a suitable mechanism through which venture and equity capital can be directed to less known enterprises. The further development of such activities on the part of the closed-end companies can reasonably be expected, though it should be recognized that the total amount of capital available from this source must necessarily be only a small portion of their total capital assets.

PUBLIC'S DOLLAR TYPE INVESTMENTS

In recent years, as is well known, the bulk of the public savings has flowed into dollar type of investments such as increased holdings of life insurance, savings deposits, saving and loan association participations, bank deposits and, of course, Government securities. By comparison the investment company as an investment medium is still small, but the investment company idea is rapidly taking hold. There are influences at work which indicate the possibility of even more rapid expansion of this medium in the near future.

In round figures, at present, approximately $200,000,000,000 of liquid savings of individuals are in nonequity form. In 1948 this type of savings increased by probably more than $10,000,000,000—around $12,000,000,000—while, according to the September 1949 Statistical

Bulletin of the Securities and Exchange Commission, total new common stock offered for cash in the United States during 1948 was only $611,000,000.

Unlike the life insurance companies and savings institutions, whose portfolios for the most part are comprised almost wholly of debt-type securities, the investment company primarily devotes itself to spreading and increasing equity ownership.

At the end of 1948, 126 of our member companies—87 open-end and 39 closed-end—reported a total of 1,031,000 stockholders with average investment holdings of only $2,180. (The average investment of open-end holders was $2,085 and that of the closed-end holders was $2,410.)

During the 8 years 1941–48, the number of shareholders of the open-end companies increased from 296,000 to 722,000 and by now probably exceeds three-quarters of a million. The number of closed-end shareholders decreased from 466,000 to 309,000, reflecting in part the repurchase or retirement of outstanding shares by the companies themselves.

There are, as you know and as you undoubtedly will hear from other witnesses at these hearings, other sources of new equity capital. To keep some perspective with respect to the problem, we realize that our contribution to the new equity capital total is relatively small. In 1948 new corporate funds were available to industry in an amount approximating $28,000,000,000. Of this amount depreciation and retained earnings made a direct contribution to the total new equity capital in the neighborhood of $18,000,000,000. Indirectly, increased commitments in common stocks by endowment funds, fiduciaries, and fire and casualty companies provided support for the equity capital market through assisting the flotation of new issues of an equity character, although the total of new common and preferred stocks issued and subscribed for by the public amounted to only $1,000,000,000.

A NEW CLASS OF INVESTOR

As the investment-company idea grows, it facilities the distribution of large concentrations of common-stock holdings. The mathematics of the graduated personal income tax rates make tax-exempt bonds an attractive substitute for common stocks for either the very wealthy or the high bracket, salaried employee. The common-stock holdings coming in supply for the above obvious reasons must be absorbed by a new class of investor—the prosperous farmer or wage earner, professional man or small-business proprietor, participating in our high level of national income but as yet in an income tax range where the yield on common stocks after taxes is still attractive to him. That this new group of investors exists is borne out by the following figures released by the United States Treasury Department and the Federal Reserve Board: As recently as 1937 individuals with incomes of under $3,000 a year received 85 percent of our population's money income after taxes. Those having incomes of from $3,000 to $7,500 received but 7 percent. Conversely in 1948 those in the under $3,000 class had dropped from 85 percent to 32 percent while those in the $3,000 to $7,500 class increased from 7 percent to 51 percent. In this great increase of the moderately well-to-do lies part of the answer to the great growth of investment-company sales.

However, if it is desirable to spread equity ownership over a larger proportion of these new investors, there is a long way to go. A survey of consumer finances by the Federal Reserve Board in 1949 disclosed that only 8 percent of those individuals with incomes above $3,000 a year held stocks. In the 3 years 1946 to 1948, inclusive, less than 4½ percent of net capital formation was financed by issues of stock for new money.

TREND OF LEGISLATION

This new class of investor must also absorb the large concentrations of stock offered by estates of deceased persons in order to raise funds with which to pay estate taxes, both State and Federal. The pressure of this liquidation is constant, and but for the new funds coming through the investment company seeking this type of equity investment, it is our belief that the current so-called equity capital problem would be that much more acute. Finally, the continued growth of the investment company, in our opinion, is probable, as it becomes more generally accepted that diversification and management in this form tend to minimize risk and therefore improve over-all investment expectations. There are indications—indeed certain States have already taken the lead in this respect—that both by court decision and/or legislative action fiduciaries, both private and corporate, and other institutions of a quasi-fiduciary character may specifically be permitted to purchase investment-company shares. As, State by State, this recognition of the suitability of investment-company securities for use by fiduciaries develops further, and we think that the probabilities lie in this direction, another great new group of equity holders will emerge.

In summary, the main thought we would leave with you is that the investment company is a relatively small but growing distributor of equity capital to a new and rapidly increasing group of potential equity holders. I will be glad to attempt to answer any questions to the extent that I am qualified.

The CHAIRMAN. May I make this comment, Mr. Stires, with respect to your comparison of figures on the percentage of incomes, under certain levels as revealed by the Treasury and the Federal Reserve Board.

I happened to make this computation just the other day during the testimony of one of the witnesses, based upon a table in our little booklet, Factors Affecting Volume and Stability of Private Investment, of the income returns as of 1946, I think it was. In any event more than 70,000,000 tax returns reported taxable net incomes of a little over $134,000,000,000. The incomes reported by those having incomes of $10,000 or less totaled $115,000,000,000 which, I observed, is precisely 85 percent.

Mr. STIRES. Yes.

The CHAIRMAN. So that from 1937 to 1948, in 11 years, the income receipts of those at the bottom of the scale have so increased that now a total of 85 percent is in $10,000 and under.

Mr. STIRES. Right.

The CHAIRMAN. As compared with only $3,000 in 1937.

Mr. STIRES. Yes.

The CHAIRMAN. In other words, there has been during this particular period a very tremendous increase of the distribution of national income.

Mr. STIRES. Correct, sir.

The CHAIRMAN. There is no question about that at all.

Mr. STIRES. Apparently none.

The CHAIRMAN. And that has transpired in the face of all of the adverse conditions which we are supposed to believe exist.

Mr. STIRES. Correct.

The CHAIRMAN. And it does bring in a new class of investor, and it also creates a new reservoir of savings which can be tapped to maintain what we call the free enterprise system.

Mr. STIRES. Yes, but it should not be overlooked that also the cost of living has risen considerably in that period. So that while the lower income fellow has got a great many more dollars, not all of the difference is available for savings or investment.

The CHAIRMAN. No; but in 9 years the assets of the open-end investment companies have increased almost 300 percent, as you expressed the matter to us.

Mr. STIRES. Right.

The CHAIRMAN. Now to what do you attribute this increase of investment? There is some increase obviously, is there not?

Mr. STIRES. You mean in our own sales of these investment companies?

The CHAIRMAN. Yes.

Mr. STIRES. I think it probably is the product of a number of influences: One, good salesmanship. They have sold these things very intensively through dealer organizations throughout the country.

Two. As I think we have said here, the realization that diversification and management tend to diminish risk has made the public more willing to buy a diversified package of securities than to buy any one. And that has been very well sold to the public.

Three. Certainly a participation in the great rise in the total national income, making the selling climate that much more attractive.

The CHAIRMAN. And those are the considerations which you believe are primarily responsible for this?

Mr. STIRES. I would think so.

The CHAIRMAN. Is it your opinion, however, that this increase solves our problem?

Mr. STIRES. By no means. It simply makes a contribution. And as I have attempted to point out in the text, we realize as yet it is a small contribution. Without it, I would say it would be that much more acute.

The CHAIRMAN. I gather from your statement that even though these companies are providing some investment in common stocks, they are, however, dealing chiefly in the so-called blue chips?

Mr. STIRES. Yes, by and large.

The CHAIRMAN. So that this accumulation of savings represented by the purchase of stock in the investment companies, both open and closed end, does not represent a substantial contribution, or any contribution at all, to the solution of the venture capital problem with which we are dealing.

Mr. STIRES. I think it does make a contribution, sir, both directly and indirectly, and maybe its indirect contribution is as important as its direct.

In other words, without a healthy, so-called equity capital market, it is our opinion that the market for venture capital would be that much more difficult. And if the stocks of seasoned enterprise are selling at a discount in terms of their book values, how much more difficult is it to sell something new and untried. That, I think, is an indirect contribution.

Directly, as I think you have heard here, they make some small contribution to venture capital through their own investments in venture enterprise. But I do not think the indirect contribution in improving the market for seasoned securities should be overlooked.

Mr. SCOLL. The open-end company, as you have pointed out, is required by law to redeem its shares on demand. To redeem those shares you have to sell securities from your portfolio, or you have to acquire the cash to redeem them by liquidating your own investments, do you not?

Mr. STIRES. May I make one statement here?

First of all, in this questioning period, if you do not mind, I would like to have my answers considered as my own rather than that I am answering for the association. The statement is the association's. I am not sure that my answers to all these questions would be entirely acceptable to all of the investment companies of the country.

Mr. SCOLL. When you speak as Hardwick Stires, who do you represent aside from investment companies—Scudder, Stevens & Clark?

Mr. STIRES. I would speak as representing the Scudder, Stevens & Clark Fund, which is an investment company.

Mr. SCOLL. All right.

Mr. STIRES. To get back to your question, sir. My guess would be—and it is only a guess—that most investment companies have a normal rate of redemption, and can take care of normal rate of redemption through working cash balances and require no liquidation of securities of any kind; and that they have developed enough experience to know how much cash they need on hand to take care of redemptions. Furthermore, they have got new funds coming in at all times, at least they have so far, in excess of their redemptions, so it has not been a problem.

Mr. SCOLL. Have the purchases always exceeded the redemptions for your company?

Mr. STIRES. Yes.

Mr. SCOLL. Since the beginning?

Mr. STIRES. Since the beginning, since 1928—every year.

Mr. SCOLL. The company was formed in 1928?

Mr. STIRES. In 1928; yes.

Mr. SCOLL. That means right straight through the stock market crash?

Mr. STIRES. Every year, including the years of 1931, 1932, and 1933.

Mr. SCOLL. So on the basis of that experience, are you prepared to hazard the statement that purchases will always exceed redemptions?

Mr. STIRES. By no means. I would say it has the appearance of being pretty depression proof.

Mr. SCOLL. But it might happen that in some period, because of events which you might not now be able to foresee, that redemptions might exceed new purchases?

Mr. STIRES. In order to take care of that contingency—I do not know if it is an entire answer but it is at least contemplating that possibility—Scudder, Stevens & Clark Fund, I believe, in its prospectus reserves the right to distribute in kind, if necessary, and not to flood the market with securities.

Mr. SCOLL. So that if you were faced with that problem you would just distribute your underlying securities to your own holders instead of dumping them on the market?

Mr. STIRES. All I can say is we have that right. As you brought out, if it was not necessary in the year of the depression, 1932, if your shares outstanding increased and your net sales increased, it is hard to envisage a worse situation than that arising.

Mr. SCOLL. Of course, I did not bring it out, you brought it out.

But to go back to this question that the Senator raised with respect to the portfolios of the companies and your company in particular.

The extent to which you are permitted to engage in investments which constitute new capital formation is pretty much limited to the established companies. You might buy a new issue of General Electric or General Motors or telephone, or one of those companies, but not a new issue of X Y Z products, some unknown new company. That is generally true, is it not? That is the burden of your statement, really, is it not?

Mr. STIRES. Well, I would say that most companies are self-limited in their statement of policy as to what they do. But I do not think we would be prohibited from buying less than 5 percent commitment, for example, of American Research and Development, which is directed entirely to venture capital.

Mr. SCOLL. So that your participation in such new capital formation would be relatively small?

Mr. STIRES. Correct.

Mr. SCOLL. The testimony and the statistics that have been brought to the attention of the committee in these hearings seem to indicate that there is a lack of venture capital available to many concerns which could be classed as small or intermediate-sized businesses for capital expansion. This is especially true in the case of companies that do not have established earning records, do not have good, solid balance sheets, and the other amenities of long-established successful business.

Now have you, as an investment counselor and member of the firm of Scudder, Stevens & Clark, ever encountered in your experience the existence of that fact?

Mr. STIRES. Now you are asking me in another capacity other than as an officer and director of Scudder, Stevens & Clark Fund?

Mr. SCOLL. Yes.

Mr. STIRES. The investment company, as such, the Scudder, Stevens & Clark Fund, is of no great assistance in this area.

Mr. SCOLL. That is right.

I am talking to you now as Mr. Hardwick Stires, who is appearing here in your third capacity as an experienced investment counselor.

Mr. STIRES. Again, I would say in that capacity by and large, investment counsel, if I can generalize, like investment trusts, tend to restrict their investments to the larger and more readily marketable listed securities and do not get into the securities of the smaller company.

Mr. SCOLL. Yes, I realize that. What I was asking was directed to whether or not your experience or your knowledge of investment and markets, and flow of capital, would confirm the testimony that has been brought to this committee with respect to the question of availability of new capital, or risk capital, for small intermediate-sized businesses. You would say that agrees with your experience?

Mr. STIRES. I concur it is more difficult for a smaller enterprise to raise capital than for a well-established one, certainly—far more difficult.

Mr. SCOLL. Now this committee is concerned with that particular problem, and I wonder if you have any suggestion that you would like to make to us in that regard.

Mr. STIRES. I do not believe I could be of help, sir, in that area. As I said before, I believe that we can make a contribution, an indirect one, through assisting established enterprises to raise equity capital.

Mr. SCOLL. You would rather duck that one?

Mr. STIRES. Since we make no contribution and I am not in that business and never have been in the business, I do not think I could be very helpful.

Mr. SCOLL. Going to this question referred to on page 4 of your statement, about the percentage of individual companies which are held by the various investment companies.

Mr. STIRES. Yes, sir.

Mr. SCOLL. Here you have reference to the fact that the 96 investment companies bought total investments amounting to 3.6 percent of their assets in corporations of which they owned more than 5 percent of voting securities. Five percent in some companies is a fairly large block of stock, is it not, for management purposes?

Mr. STIRES. Yes.

Mr. SCOLL. And some go even higher, as indicated here, as much as 25 percent which, I think, you will concede is viable control of some companies or at least management control?

Mr. STIRES. That is right.

Mr. SCOLL. Can you speak for the companies, or for the Scudder, Stevens & Clark Fund, and state what is their policy with respect to exercising that voting franchise?

Mr. STIRES. I would say it probably varies widely, Mr. Scoll. In the first place, that figure comprises both the open-end companies and the closed-end companies. And some closed-end companies are really formed as management companies. If I remember correctly, the Atlas Corp. consists largely today of two stocks: Barnsdall Oil and Consolidated Vultee.

But Scudder, Stevens & Clark Fund is an open-end company, and you will see in the next sentence that the 68 open-end companies reported no holdings representing more than 25 percent of voting power, and only less than 1 percent of assets in investments representing more than 5 percent of voting power. So that other condition is virtually exclusively that of the closed-end companies.

Mr. SCOLL. Then what is the policy with respect to the open-end companies in the exercise of their voting franchise in those companies where they hold 5 percent or more? Do you vote stock?

Mr. STIRES. Oh, yes; the company votes the stock. I would say broadly speaking—let me speak from our own experience. We have tended to vote our stock, and if we are dissatisfied with the management, we have tended to dispose of the stock rather than attempt to take any acion with a very small amount of stock.

The CHAIRMAN. You watch management as well as earnings, do you not?

Mr. STIRES. Yes, sir.

The CHAIRMAN. In all your investments?

Mr. STIRES. Very closely.

The CHAIRMAN. But obviously the difference between 5 and 25 percent of voting stock is quite a considerable range. And any single holder of more than 20 percent of the stock of any company, the stock of which is widely distributed, would necessarily be a very powerful factor in management, would it not?

Mr. STIRES. Indeed.

The CHAIRMAN. Now what proportion do you suppose of this voting stock is between, let us say, 15 and 25 percent?

Mr. STIRES. I would have to guess. In the closed-end field—well, we can get you those figures later on if you want them.

The CHAIRMAN. Well, the closed-end field, there the tendency is to go into management completely; is it not?

Mr. STIRES. No; not necessarily. I would say only in a very few instances even in the closed-end field are closed-end companies in that capacity. Most of them, I would say, are general-investment portfolios not dissimilar to the open-end field.

In the open-end field I would think the percentage would be minute of companies that had more than 5 percent of voting power in any one company.

The CHAIRMAN. The impression that you leave is that by and large these investors do not seek to exercise the voting power.

Mr. STIRES. As a group; except in rare instances in the closed-end field.

The CHAIRMAN. There are exceptions, naturally.

Mr. STIRES. Yes.

The CHAIRMAN. But you do watch your management, and if you are dissatisfied with management, then instead of precipitating a battle for proxies, you just get out?

Mr. STIRES. By and large. But I do not want to speak for all of them. Some of them are extremely vocal with management and engage in managerial rows, and so forth, either successfully or unsuccessfully in behalf of the stockholders.

The CHAIRMAN. You have given us the average holdings of these 1,031,000 stockholders. Have you any figures on the median holding?

Mr. STIRES. I have not, sir. If you will permit me to call on Mr. Sheffey. I see he has not got them either.

The CHAIRMAN. That would be a very interesting figure.

Mr. STIRES. I guess they would not be far from the average, but we will see if we can develop it.

The CHAIRMAN. Would you be good enough to to look into that, please?

Mr. STIRES. Yes.

The CHAIRMAN. I have noticed in corporate stockholdings, particularly in the large companies, the variation is very great. You might have a company, for example—I have one in mind at the moment, the average stockholding of which is 50 shares, but more than half of the stockholders in this particular company as of the time when I saw the figures owned less than 12 shares each.

(Mr. Stires subsequently supplied the following comment on this point:)

I have had a study made of the stockholdings of the Scudder, Stevens & Clark Fund, Inc., as of August 31, 1949. As of that date the average holding was 161 shares worth at that time $7,798.84. The median holding as of the same date was 70 shares worth $3,390.80.

This bears out Senator O'Mahoney's point and makes my guess not a very good one. I would like to add, however, that this discrepancy between the median and the average in the case of the Scudder Fund is brought about by a large quantity of very small shareholdings rather than any large concentrations at the other end. Scudder, Stevens & Clark Fund's average and median are way above the average and median for the industry.

Mr. STIRES. Right.

The CHAIRMAN. You see the net effect of that is increasing the power of management because the smaller the stockholding, the less influence the individual stockholder has.

Mr. STIRES. I think you will find that I am close to right in my guess that the median is going to be close to the average in this case.

The CHAIRMAN. That would mean, then, as far as these companies are concerned on which you have given us these statistics, there are really very few large holdings of stock.

Mr. STIRES. Right, sir. You see in these cases you have not got a founding family, or an original large stockholder from whom has emanated stock that the public owns. These things have been built up piecemeal by small public investment, and my guess would be the median would be close to the average.

The CHAIRMAN. Would you care to make some comment on public regulation of these companies, both under the Federal law and under the State laws?

Mr. STIRES. Nothing, sir, except to say it seems to be working very well in both instances.

The CHAIRMAN. It is adequate in your judgment?

Mr. STIRES. It appears to be. I know of no outrages.

The CHAIRMAN. I personally have heard of no complaints.

Naturally the question of public regulation in the investment field always is a matter of great interest.

Mr. STIRES. Right, sir.

The CHAIRMAN. What, in your judgment, gave rise to this new form of investment?

Mr. STIRES. Well, as I brought out in the text, sir, it is an old form of investment on the Continent, a very old one, over 100 years old.

And in the natural course of development of our great corporate life here and the distribution of its securities, the investment banking firms discovered that with this new investor class arising the purchase of any one security in and of itself contained great risks, and that a package of risks, or diversified risks, with management, containing, therefore, relatively less risk, was a salable commodity and a proper contribution to the economy as such.

The CHAIRMAN. I wonder if it is your experience that the managers of the investment trust companies have tended to develop any standard of responsibility and conduct to which you would like to see, and do insist, perhaps, that the managers of the companies in which you invest adhere.

Mr. STIRES. I believe they are men of high character who recognize their fiduciary responsibilities.

The CHAIRMAN. Yes, I assume that. But I mean do these investment companies tend to develop any standards by which they measure the managers of the big "blue chips."

Mr. STIRES. I do not think they can erect a yardstick against which they can measure management and decide——

The CHAIRMAN. I did not mean to suggest that they control at all. What I am thinking of is: In your investigation, in your study of a particular stock, you look into the normal factors of earning power, assets, and all of that?

Mr. STIRES. Yes.

The CHAIRMAN. And then you also look into the capacity of management, do you not?

Mr. STIRES. Yes, sir.

The CHAIRMAN. Do you have any standards by which you judge the efficiency of management?

Mr. STIRES. Well, there is one quick and easy standard. That is the continued profitability and growth of the company. Is it keeping its place in the industry? Is it losing its position with respect to its competitors? Are its labor relations poorer than those of its competitors?

There are no cut and dried standards, but after all the income account and the balance sheet are pretty cruel judges of managerial ability.

The CHAIRMAN. I am wondering if the development of the investment company, the managers of which must necessarily be primarily concerned about making profits for their own stockholders—I am wondering if the result of all of this is a tendency to make management on the whole a little bit more responsible in the other fields, too.

Mr. STIRES. I would think we might be a prophylactic.

The CHAIRMAN. Dr. Kreps?

Mr. KREPS. I would like to go back to page 2, the top of page 2, in your testimony. You state there:

> In comparison with the total of funds in the care of insurance companies, savings banks, and trust companies of this country, the total under the supervision of investment companies is relatively small.

That leads me to ask whether you would hazard a relative guess as to how much money is under the supervision of trust companies.

Mr. STIRES. I would not dare guess, sir.

Mr. KREPS. Is it relatively large, would you say?

Mr. STIRES. Relatively large, but to the best of my knowledge no such figure exists.

Mr. KREPS. Do you have any guess, then, what percent, or how much, a typical trust company under the limitations of its trust instruments might be able to put into, say, common stocks?

Mr. STIRES. It would be impossible to guess, sir. It would depend, for one thing, whether it is a prudent-man State, so-called, or legalist State. They might be estopped from buying any common stocks unless specifically permitted to do so by the instrument. It would vary very, very widely, particularly by States.

Mr. KREPS. What would it be in Massachusetts?

Mr. STIRES. Massachusetts has the so-called prudent-man rule where they can invest in common stocks as a prudent investor would.

Mr. KREPS. That is, they have no limitations other than the prudent-investment rule?

Mr. STIRES. I believe so. I am not a Massachusetts resident but I believe that is the case.

Mr. KREPS. Do you have a feeling that they do or do not venture and try to invest as much as they might be able under their investments to invest in common stock, or whether they fall short of that a good bit?

Mr. STIRES. You are asking me to speak for a trust company. I have never worked in one in my life. But my guess would be that they would tend to adhere as strictly as possible to the trust instrument and be very careful about any purchases of equity unless they were specifically permitted to do so, or unless the laws and court decisions in their State were favorable to that type of investment.

Mr. KREPS. Since I cannot seem to get the information from you, would you tell me where I might get such facts or such information, or where the committee might get it?

Mr. STIRES. I cannot think of any better place, sir, than to go to the trust companies themselves and see if you can get any statement from them. I cannot think of any outside source that would be as successful as the trust companies themselves.

Mr. KREPS. There seem to be no published sources.

Mr. STIRES. I do not believe so.

Mr. KREPS. That has been my experience.

Mr. STIRES. I have never seen them.

Mr. KREPS. Among other things I read every issue of the Wall Street Journal and Barron's. On several occasions I have seen reports of various types of investment and of the hypothetical results of the investment of $100,000 for a widow.

Mr. STIRES. Contests, et cetera.

Mr. KREPS. Do you know of a study, or possibly you have made such a study, in which, say, over the last 30 years, or so, some test has been made to indicate—in view of increases in the cost of living, regularity and amount of income, appreciation, and similar criteria—whether a well-diversified investment in common stock has proved, or does seem to prove, superior or inferior to, say, a group of securities that are regarded as "legals" for investment by life-insurance companies or savings banks in the State of New York?

Mr. STIRES. For the period you mention, in the past 30 years, my guess would be that a well-selected diversified list of common stocks would have had a far superior performance both principalwise and incomewise to a group of fixed income-bearing securities.

Mr. KREPS. Do you know of any objective studies we might utilize? I know there is one under way by the National Bureau of Economic Research. But have you made such a study in your research on this problem in guiding your own investment policy?

Mr. STIRES. Well, I think you can take certain specific funds, even certain of these hypothetical funds you speak of, and bring them forward and I think they will bear out your implied thought that a diversified group of stocks over such a period have had a superior record to a group of fixed-income-bearing securities.

Mr. KREPS. Then I am presented with somewhat of a puzzle. I know that trust officers are, and have to be, ultra-conservative. In some cases they are in banks that are relatively small and cannot employ at least what I think you would regard as competent over-all staff to look at various types of securities and follow developments in various industries, and the rest, and make really the best type of investment decisions. So they tend to hesitate, to invest probably in Government bonds, or something that has the reputability of security rather than conforming to the experience which my reading of the Wall Street Journal and Barron's and your experience seems to bear out. Is that your judgment? Is that an accurate statement?

Mr. STIRES. I think I can give you one reason for it. You and I are talking about the over-all performance of a diversified list of common stocks over a period of time. The trustee is responsible not only for the over-all performance of the funds under his supervision but for the individual performance of every stock in a portfolio. And he may have to defend himself in a surcharge action, let us say, of any one individual stock whereas the trust, as a trust, may have appreciated 100 percent under his management.

Mr. KREPS. That would seem to suggest that maybe there ought to be something like an open-end investment trust for trust officers.

Mr. STIRES. Well, in many cases there are. Individual trust companies have established their own so-called common fund, which is a pooled fund in which they participate in their small trusts.

Mr. KREPS. That would be only within a given trust company, would it not?

Mr. STIRES. That is right.

Mr. KREPS. They might not be large enough, again, to afford the kind of competent research that is needed.

Mr. STIRES. That is correct.

Mr. KREPS. The question often arises: Why are not more of the open-end investment trust securities sold on the stock market itself rather than being quoted, I believe, over the counter, with one price at which you buy and a different price at which you sell on the same day? Are there any open-end investment trusts that do sell on the big board?

Mr. STIRES. No, sir.

Mr. KREPS. And could you explain what that difference is? That is sometimes misunderstood. I would like to get it clear.

Mr. STIRES. The closed-end companies are the companies that sell by and large on the big board, if at all, let's say.

The open-end companies, by definition, as we have said, are forced to redeem their shares upon demand by the shareholder. In other words, he has to be paid the net asset value of his holding as of a given day, whereas the shares that are sold on the stock exchange are thrown, if you want, on the market, and the shareholder who wishes to dispose of them gets only what somebody else is willing to pay him for them.

So sometimes closed-end shares sell at a premium on the stock market; sometimes they sell at a large discount. Whereas the open-end shares redeem at neither a premium nor a discount, generally speaking.

The CHAIRMAN. At what figure are they redeemed?

Mr. STIRES. The open-end shares are redeemed at their net asset value.

The CHAIRMAN. Not at their purchase value, but at their asset value?

Mr. STIRES. Net asset value.

The CHAIRMAN. As of the time of the sale?

Mr. STIRES. As of the time of the redemption; yes, sir. The redeeming shareholder gets his pro rata share of what the list of securities by and large is worth as of a given day.

Mr. KREPS. That is all the questions I have.

The CHAIRMAN. Mr. Stires, we are very grateful to you for your statement. You seemed to be on top of the subject all of the time.

Mr. STIRES. Thank you, sir.

The CHAIRMAN. The next witness is Mr. Sholley.

You may identify yourself Mr. Sholley, and proceed with your statement.

STATEMENT OF SIDNEY L. SHOLLEY, PRESIDENT, KEYSTONE CUSTODIAN FUNDS, INC.

Mr. SHOLLEY. Thank you.

My name is Sidney L. Sholley. I am president of Keystone Custodian Funds, Inc., an open-end investment company.

I am here for the purpose of discussing the imbalance that exists between debt and equity in the flow of our capital and savings, and to make a proposal for your consideration which, I believe, will bring a larger and more normal proportion of capital into the equity market.

The CHAIRMAN. Where was your company organized?

Mr. SHOLLEY. It was organized in Philadelphia. It is now located in Boston. It was organized in 1932.

The CHAIRMAN. Under what State law?

Mr. SHOLLEY. Under Delaware law. The original operating company was in Philadelphia and moved to Boston in 1938.

Our economists have estimated that we now require $5,000,000,000 of new equity capital each year over the next 10 years to maintain our system of free enterprise in a sound and healthy condition; $5,000,000,000 to finance new ventures, to enable small business to expand, to make enough jobs for a growing population and to provide a steadily growing tax base for the support of the Government.

The CHAIRMAN. May I interrupt there, Mr. Sholley?

Dr. Kreps seems to think he wants to ask a question at this point.

Mr. KREPS. I noticed that you did not indicate how that $5,000,000,000 estimate was obtained.

Mr. SHOLLEY. I shall be glad to do so either now or at the end.

Mr. KREPS. You prefer to answer at the end of your statement?

Mr. SHOLLEY. If you please, sir.

Mr. KREPS. All right.

Mr. SHOLLEY. There are two things that are interesting about this $5,000,000,000 figure. The first is that it is a larger amount of equity capital than we have ever raised in any single year in our history, The highest previous total was 4.4 billions. Yet the $5,000,000,000 figure is not unrealistic. Our total volume of business and employment has risen sharply. Prices are higher. It takes more capital to run a business and it will require expanding amounts as we grow.

The second observation is that our total new common-stock financing last year amounted to half a billion dollars or one-tenth of this requirement.

Our large established corporations are finding it difficult to sell new stock issues. Smaller businesses with exceptional earnings and an urgent need for more capital are finding it next to impossible to get equity money. Those with sound ideas who need only a limited amount of money for a venture are facing a blank wall.

The larger corporations are temporarily solving the problem by plowing back earnings. These businesses normally pay 60 to 70 percent of their earnings as dividends. This year they are expected to pay 30 to 40 percent. This plowing back of earnings may solve the problem for an individual company if the earnings are sufficiently large to finance the needed growth and expansion but a smaller busines which needs to double or treble its capital cannot do it out of the earnings and the venture, as yet, has no earnings at all. If the problem is left to the plowing back of earnings, our big businesses must get bigger and our small businesses will find it increasingly difficult to survive.

Our equity capital market is obviously starving and ironically enough it is starving in the face of plenty. The accumulated liquid savings of the American people total $175,000,000,000. The savings of the American people last year were $12,000,000,000—more than twice our equity capital needs. Why then does our equity market starve?

The survey recently completed by the Federal Reserve bank tells us that 8 families, or spending units, out of 100 own common stocks, and half of these own less than $1,000 worth. Ninety-two families out of one hundred have no direct stake in the ownership of our system of free enterprise. The ninety-two were asked why they did not own stocks and the answers were about evenly divided between those who thought stocks were "risky" and those who knew nothing about them whatever. The problem here is clearly ignorance. The American people understand life insurance. That is why 6.9 of the 12 billion dollars saved last year went into insurance. But insurance company investments are restricted almost entirely to bonds.

This money, therefore, must seek debt investment. It is not available to the equity market. Another 3.3 billions went into United States savings bonds and State and municipal obligations. Savings and loan associations account for 1.1 billions. This, too, is all debt money. It cannot flow into the equity market as productive capital.

A total of 1.7 billions did finally find its way into corporate securities but since the total equity issues of last year were only $500,000,000, it is obvious that more than two-thirds of this corporate investment went into debt securities.

The imbalance of our capital market is also clearly indicated in the markets themselves. The flood of money that is flowing through insurance companies, savings banks, and other channels has created a demand for debt securities that has driven interest rates on high-grade corporate bonds to the historically low level of 2.9 percent.

In contrast, the lack of interest in equities is revealed by the fact that common stocks of our leading businesses are selling at substantially less than 10 times earnings as compared with normal ratios of from 15 to 20 times earnings. Stocks that have paid dividends without interruption for 20 or 30 years can be bought with current yields of 6, 7, and 8 percent. If the investor who has capital for equity investment can buy into the ownership of a large and established business at the lowest price on record in relation to its earnings and gain an unusualy generous current return in dividends, why should he assume greater risks in a smaller and less well established business and why should he assume the additional hazards that are present in every new venture?

Historically, money has only been available in quantity for smaller businesses and new ventures when the stocks of established businesses were selling at relatively high prices and on a low-yield basis.

Now if a stream has left its normal channel there are two things that can be done about it. We can try to dam up the new channel and force it back into the old one, or we can deepen and widen the old channel so that it will be easy for the water to flow where we want it to flow. And I believe that we can restore a more normal flow of equity capital through a simple tax incentive. I refer specifically to a dividend-received credit.

Under such a plan a corporation would make its tax return and pay its tax just as it does today. The individual would include all dividends received with other income and compute his tax exactly as he does today. Then there would be one more line on the tax return which would be labeled "Dividend-received credit." It would instruct the taxpayer to compute an amount equal to 20 percent of the dividends included in the return and claim it as a credit to be deducted from the tax due.

This would, in effect, reduce the Federal tax rate on dividend income by 20 percent for taxpayers in all tax brackets. The man subject to the effective rate of 77 percent would pay 57 percent on dividend income. The taxpayer with an effective rate of 40 percent would pay 20 percent on dividend income. The taxpayer with a small income who now pays 20 percent would pay no tax on dividend income. It is evident that the benefit is increasingly important to lower-bracket taxpayers.

What are the chances that such a tax incentive will be effective in attracting the $5,000,000,000 of equity capital that is needed?

If we want a demonstration of the effectiveness of a tax incentive, we need look no further than our present market for tax-free bonds. Here we find $36,000,000,000 earning a very low rate of return. Money flows in and out of the tax-free market on the delicate balance between the net return on taxable securities and the gross return on tax-free securities.

As the balance now stands, our equity markets are deprived of billions of dollars of needed capital and the Government collects no tax. A 20 percent dividend-received credit might well bring hundreds of millions of dollars of this capital out of hiding and into productive use where it would again also contribute tax revenue.

We have another demonstration of the effectiveness of a tax incentive in the field of petroleum exploration and development. In order to encourage risk capital to engage in the hazardous search for new supplies of oil, Congress has provided tax incentives—the deduction of development expense, a full tax credit for all losses on "dry holes" and a depletion allowance on income received from producing wells. As a result of these tax incentives ample capital has been available at all times for the hazardous business of oil exploration and development.

The CHAIRMAN. May I interrupt you at that point to say that just a few years ago the Congress passed a bill which originated in what was then the Public Lands Committee of the Senate. I was one of the sponsors of the bill which sought to provide an additional incentive for the development of petroleum lands on the public domain by providing a flat rate of 12½ percent instead of a sliding-scale rate for the discovery of oil on new lands, thereby creating an incentive. The result has been to tremendously increase the search for oil upon the public domain. And I am very happy to be able to say that my own State has shown the greatest progress in developing new deposits of oil.

Mr. SHOLLEY. Well, the tax incentive works.

The CHAIRMAN. Yes.

Mr. SHOLLEY. The probable effect of a dividend-received credit on our 92 families who own no stake in our productive system is even more interesting. Every taxpayer has a natural and keen interest in any benefit or credit that the law allows him in connection with his taxes. If he hears of such a benefit or credit that he doesn't understand, he makes it his business to find out about it. And in the process of finding out, several million inquiring taxpayers will, of necessity, find out what a dividend is, where it comes from, and what it represents.

They will then be able to compare equity investment with other forms of investment with which they are already familiar. It will take less than one-half of our current national savings to supply all of the equity capital we need.

And the theoretical cost of such a dividend-received credit may well turn out to be a profit so far as the Treasury is concerned. The restoration of a more normal flow of capital and savings into equities will expand many small businesses and create many new businesses with a consequent increase in employment and total pay rolls. Objectively, it will greatly broaden and strengthen the base from which future corporate and individual taxes must come.

But above all else, it will do much to maintain the American system of capitalism and free enterprise and thus insure the continued growth and prosperity of our country.

The CHAIRMAN. Why did you hit upon the 20 percent credit?

Mr. SHOLLEY. Well, that figure, Senator, is neither arbitrary nor accidental. As a matter of fact, when our income-tax system was inaugurated in 1913, the Congress recognized that the normal tax on the earnings had already been paid by the corporation, and the income in the hands of the individual, or dividend income, was only made subject to the surtax rates rather than the normal tax.

That situation continued until 1936. At that time the House of Representatives considered a new tax bill in which they were going to relieve the corporation of tax on the proportion of earnings which were distributed as dividends, and they were going to collect in place of that a tax on undistributed earnings. And in the face of that prospect they changed the individual section of our tax law to make the dividend fully taxable in the hands of shareholders in all tax brackets because that was the only place it was going to be taxed under that theory.

The Senate in 1936 did not go along with the House proposal. It restored the corporate tax on the distributed portion of earnings and adopted a moderated undistributed profits tax to go along with it.

As nearly as we can determine by reading the record, it was oversight. They forgot to restore the situation that had previously existed as far as individual taxes were concerned, and our dividends became fully taxable in 1936 by what appears to be an oversight.

The 20 percent rate is the first rate of our income tax bracket at the present time and, therefore, a 20 percent dividend-received credit would substantially restore the situation that existed prior to 1936.

Mr. SCOLL. So everything in excess of 20 percent would be taxed at what is now the graduated rate?

Mr. SHOLLEY. That is correct.

Mr. SCOLL. Above the 20-percent level?

Mr. SHOLLEY. Well, under this proposal the taxpayer pays whatever his rate is. And presumably the top-bracket rate on income would apply because it is ordinarily income that you count after your regular income. It would simply mean his rate would be reduced by 20 percent, whatever his individual rate might be.

Mr. SCOLL. Where are you going to make up the lost revenue? Where would the Treasury make up the lost revenue?

Mr. SHOLLEY. Well, in the first place, the Treasury has estimated a 20 percent dividend-received credit would have no effect on corporate taxes. It would reduce tax receipts on individual incomes by $1,400,000,000. And I have indicated here that I believe the theoretical cost will become a profit in a reasonably short time.

But if we are assuming it must be recovered immediately, I call your attention to the fact we now have a 38 percent corporate rate which produces $19,000,000,000, or at the rate of approximately one-half a billion dollars per 1 percent of the tax. A 3 percent increase in the corporate rate would appear to recover more than the cost of the dividend-received credit so far as the tax receipts are concerned.

Mr. SCOLL. So you would then advocate a compensating increase in the corporate tax rate?

Mr. SHOLLEY. If it is felt that the revenue must be immediately restored; yes.

Mr. SCOLL. There is one further question I do not think you have answered.

The dividend-received credit is all right for the taxpayer who receives dividends. What about the wage-earning taxpayer, all of whose income is from wages and none from dividends? He does not get any dividend income, therefore, he has no dividend tax credit. Is it not likely to be charged a dividend-credit provision would be discrimination?

Mr. SHOLLEY. Well, it might possibly be. I am not advocating a reduction of individual income taxes here, I am advocating a tax incentive to try to attract a normal flow of capital into our equity market.

The CHAIRMAN. Your argument is that this would provide by the amount of the reduction of collections on individual income taxes a new fund which would be available for equity investment.

Mr. SHOLLEY. That is possible, but that is not the principal benefit of such a plan as I see it.

If we have a single line at the bottom of our individual tax return after the total has been figured that the taxpayer must pay, which says, "Dividend-received credit—compute 20 percent of the dividends included in the above tax return and claim it as a deduction on the tax due." I believe that several million taxpayers will make it their business to find out what that credit is about. And I believe it will have a very material effect on the 92 families, or spending units, out of 100 today who own no part in our productive system and who, as a matter of fact, show very little interest in wanting to find out anything about it.

This is, frankly, a tax incentive to try to draw that group's attention to this, and their portion of the savings would adequately supply our shortages in that direction.

I think from the point of view of the wealthier people who have traditionally supplied the credit, it will encourage a larger proportion of their money to go into equity investments as against tax-free investment. And I think that is a very healthy thing for our general economy.

Mr. SCOLL. So you mean it would bid up the price of the seasoned stocks on the market, thereby reducing the yield spread between seasoned equities and debt, and thereby make equity financing more attractive. Is that the theory?

Mr. SHOLLEY. I should think it would help to correct this imbalance.

Last year our common-stock financing was 15 percent of our total financing, which is an extraordinarily—it is too low a figure. Because if you are going to go on financing through debt, in the first place, we are going to dilute the protection for debt itself, and in the second place, business loses its flexibility and in a depression or change of time or condition, they are much more vulnerable than they would be if they had a more healthy proportion of equity financing.

And again to get back to the particular interest of your committee, the venture and the small business has to have equity money. They cannot borrow because to a great extent they have no assets to pledge. They are looking toward the future rather than toward the past.

Mr. SCOLL. Have you familiarized yourself with the Kaplan Capital Bank plan in general, in the outlines of it?

Mr. SHOLLEY. I have not made a detailed study of it, and I may not understand it entirely.

I do gather the plan is to have a new type of company which might be called a finance company, or something between the commercial bank and the Federal Reserve; the theory being that the capital of this new type of institution is supplied by the banks. It might be supplied by insurance companies and possibly investment companies as well.

The individual needs working capital for his business, and he goes to a commercial bank and tries to get an accommodation from them.

If he is a good credit risk, he could be processed by that bank. And if the type of accommodation he requires is to be supplied by this new institution, he could be referred by the local bank to a regional source of this kind. It could be run under the general supervision of the Federal Reserve System.

I would have the local banks have a direct capital stake in it because if they exercise good judgment and the thing is profitably operated they should benefit; if they do not, they should be penalized.

The Federal Reserve could also, if this plan were worked out, be authorized to rediscount some of the longer-term loans of this company, perhaps not on the basis that commercial paper is rediscounted today, but on some other basis.

In order to offset the fact that a good many of these loans do not have banking collateral in the usual sense, a portion of the equity in the business might be taken as an additional security. And a part of such equities over a period of time might well offset a higher loss ratio than the normal bank loss ratio which might result from this.

But your great problem is the financing of business between the time it gets started and until it is large enough to be publicly financed, when they need a type of accommodation that commercial banks cannot today provide, and they need a longer-term loan, or capital over a longer period.

Mr. SCOLL. I take it from your answer that you believe there is a need for such institution.

Mr. SHOLLEY. Very much.

Mr. SCOLL. And also that you believe that not only banks but possibly investment trusts and insurance companies might participate in it on a limited basis.

Mr. SHOLLEY. I think it should be open to all institutions of the type.

We have some technical problems, let me say, so far as we are concerned. But if such new type of financing institution were going to be established, and if we had an opportunity to participate in it, we certainly would look into it very carefully, and we might be able to find a way of overcoming some of the technical problems that exist as they stand today.

We have, for instance, at least one set of State regulations—I think it applies in more than one State—which prohibits our investment in a company——

Mr. SCOLL. New York.

Mr. SHOLLEY (continuing): Ohio. Not in existence for 3 years. So, until a company has been going for 3 years, we are prohibited from making investment.

Mr. Griswold has obtained a limited exemption from that for his purpose.

While I think the company sponsored by investment companies and insurance companies is a very interesting pilot plant in this direction, I think the magnitude of the problem is such that it will take a different type of machinery to really solve it.

Mr. SCOLL. You believe, then, to meet the problem on a national basis we would have to have something like these capital banks Dr. Kaplan suggests on a national basis, a regional basis?

Mr. SHOLLEY. I would think so.

The CHAIRMAN. Your suggestion of this "Dividend received credit" would not be an answer to the problem set forth on your first page in your words, "Those with sound ideas who need only a limited amount of money for a venture are facing a blank wall?"

Mr. SHOLLEY. I think it would do much, let us say, to improve the general situation, perhaps not directly on that point, but again indirectly, because if we have an increased public interest in equity investment as against debt investment, if a larger proportion of our population are actively interested in that field, the man with an idea that requires equity capital—and possibly it is purely venture capital at that point—will have a much better chance of finding someone who is interested and wants to help supply the capital than he does today.

We have a very dangerously small segment of our population who are apparently aware of the importance of ownership of our tools of production. And I think, if that group could be doubled or trebled by such a tax incentive as this, that the chance of every venture finding capital is increased two to three times what it is today. But it does not provide a direct answer to that problem.

The CHAIRMAN. The line "Dividend received credit" on the tax return would stimulate interest among all who make our tax returns.

Mr. SHOLLEY. That is right.

The CHAIRMAN. To find out what that credit is. And in the normal course of events they would learn that blue-chip stocks provide secure dividends and, therefore, they would be inclined to put their money, like the investment trusts do, in the blue-chip stocks.

Of course, it would educate more people in the possibilities of common-stock investment, but it would not answer this other aspect of business which is about to start by providing an approach for venture capital. That would have to be obtained in some other method; would it not?

Mr. SHOLLEY. Yes. If we are approaching that problem directly, some special machinery would have to be worked out for it.

The CHAIRMAN. That is why you favor the Kaplan bank method?

Mr. SHOLLEY. It is the most practical suggestion that has come to my attention on the broad proposal. But I still think our basic problem is an educational problem; that we must reeducate the American people on this subject. If we do not, it is a relatively short period of time historically until the last person who understands free enterprise and individual ownership dies and we have Government ownership by default, because there would not be anyone who understands anything else.

The CHAIRMAN. Well, I am very glad to hear you make such a bold, clear statement of the issue, because that is the issue as I see it. If we want to save the free-enterprise system, we had better be doing something about it.

Dr. Kreps?

Mr. SHOLLEY. You asked about the five billion dollars.

Dr. KREPS. Yes. If you have a technical memorandum, would you like to place it in the record?

Mr. SHOLLEY. It is quite brief and may be interesting to everyone. [Reading:]

It has been estimated by Professor Schlicter of Harvard that at the beginning of 1949 the total value of industrial equipment in place amounted to 123.7 billion dollars and the value of industrial real-estate improvements amounted to 160.6 billion dollars.

Using these figures as a base, it is estimated that provision for replacement to covering wearing out and obsolescence might be figured as follows:

The figures are 9.9 billion dollars on the industrial equipment and 4 billion dollars on the real estate, which depreciates at a much slower rate. [Reading:]

Total annual investment required to cover replacement, therefore, is 13.9 billion dollars.

In addition to providing for replacement, new capital is also required to finance the continuing expansion of plant capacity: one, to meet the needs of long-term growth in population and labor force which are equivalent to approximately 1.5 percent annually.

If we do not increase our plant as fast as our population grows, there are not going to be jobs.

And, second, to provide the increasing investment in plant and equipment per worker of around 1 percent per year needed to keep pace with continuing advances in industrial technology.

This latter advance represents the principal explanation behind the long-term rise in real living standards enjoyed by this country. It at the same time represents the basis for management's ability to preserve earning power in the face of ever-advancing wage rates.

Applying the combined estimated rate of annual increase of 2.5 percent to the combined total of industrial plant and equipment of 284.3 billion dollars an over-all capital requirement of approximately 7.1 billion dollars to care for growth in labor force and advancing technology is indicated.

Thirteen and nine-tenths billion for the maintenance of our present plant and 7.1 for our expansion amounts to 21 billion dollars. [Reading:]

Another way to arrive at a somewhat similar figure is to base it on the fact that over a long period of years an apparent normal proportion of total gross national expenditures going into plant and equipment has been in the general vicinity of 8 percent. Thus, at present levels of around $265,000,000,000 annual gross national product, a normal total for capital expenditures by business currently would be around $21,000,000,000.

You get the same figure from either of the two approaches.

If the gross national product continues to expand in the future at the rate of the past 50 years, levels of perhaps $300,000,000,000 by 1955 and $350,000,000,000 by 1960 might be witnessed. On this basis and again applying the 8-percent proportion, total business expenditures in 1955 of $24,000,000,000 and $28,000,000,000 in 1960 would be indicated.

Of the combined current total of $21,000,000,000 annual business investment, depreciation may be expected to provide around $6,000,000,000.

If corporate earnings after taxes run to around $18,000,000,000—they were around $21,000,000,000 in 1948 and will perhaps total $16,000,000,000 in 1949—and a more normal percentage of the total is paid out in dividends, say around two-thirds, then retained earnings would provide $6,000,000,000.

That means business through its depreciation and retention of earnings can provide 12 billion out of this 21 billion, but it leaves us with a shortage of 9 billion dollars which must come from some other outside source. And we believe that 50 percent of the new money going into business should be equity money, and 50 percent of that gives us $4,500,000,000 this year. It will be $5,500,000,000 in 1955 and $6,500,000,000 by 1960.

So, over the next 10 years, the five-billion estimate appears to be about right.

Mr. KREPS. Do you make any allowance for improvement in the efficiency of machinery, the kind of thing that Dr. Moulton has so well recorded in his excellent book; namely, that use is continually being made of better capital equipment, or "capital saving innovation"? Today it is not the same machine costing a thousand dollars which was used 20 years ago, but a $500 machine which, due to invention, does the same work that the $1,000 machine did. Have you made any allowance for that?

Mr. SHOLLEY. We are allowing 1 percent of the 2½-percent figure.

Mr. KREPS. That 1 percent, on the contrary, is a figure that you add. If you allowed for capital-saving innovation, say, at the rate of 1-percent improvement a year, you could deduct from your dollar amount 1 percent to allow for the fact new capital equipment was steadily getting better so that it takes less costly capital goods to do the same job as was done years ago.

We have had a good deal of testimony, not only in these hearings but in other hearings to the effect that capital-saving innovations have been the mainspring of American technological progress.

Mr. SHOLLEY. We are assuming here the productivity of the American worker is going to increase; therefore, we are going to have more and more capital invested in the worker in American business. That has been our trend.

Mr. KREPS. Let's say you make that assumption. Some of these scholars do not believe that is the trend.

The CHAIRMAN. Do they deny that is the fact in the past?

Mr. KREPS. Yes. In other words, Dr. Moulton emphatically finds that the engine of American progress has been steadily a capital-saving innovation.

Mr. SHOLLEY. That is correct, but it still calls for a larger and larger investment. It brings out a low-cost product, but the amount that must be invested in tools per workman has increased steadily in this country.

The CHAIRMAN. There seems to me to be no doubt about that.

Mr. KREPS. You can produce today the same amount of gross national product with less capital equipment than was required to produce the same amount 20 years ago.

The CHAIRMAN. But what is the use of making a statement of that kind when we must recognize that the gross national product of 20 years ago is utterly inadequate?

Mr. KREPS. Quite so. But, nonetheless, it means that in the same way you produce a better car with less capital investment necessary per thousand dollars of car——

Mr. SHOLLEY. I follow your argument.

Mr. KREPS. Than you needed 20 years ago.

The CHAIRMAN. But that can be true, but it overlooks completely the fact that there must be a much larger capital investment in these more productive tools to support the supply of goods that the increased gross income of the people demands.

Mr. KREPS. In absolute amount, of course.

The CHAIRMAN. I think, then, you are both in agreement.

Mr. KREPS. As percentage of the gross national product, no. That is the difference.

Mr. SHOLLEY. Is not this a sort of progression we are talking about?

Mr. KREPS. It is a digression.

Mr. SHOLLEY. I said "progression," not digression.

We start with the fact we are going to have more invested in machines. The machine has a greater efficiency and turns out a larger product. We also assume we are going to pay the man who runs the machine a higher wage. We may come out with four times the gross national product as a result, and the cost per unit of the product may be less, but we must have more money invested in the machine per man even if you have four times as great a product.

Mr. KREPS. I am not referring to the amount per man; I am referring to the amount per standard dollar of gross national product, the percent of gross national product that needs to go into capital investment. I am talking about that consistently.

Mr. SHOLLEY. If we are going to have a constant gross national product, if we assume we have to have so many items, then we believe the cost of items should come down. But unfortunately we want an ever-increasing gross product.

The CHAIRMAN. Now we come to prices.

Mr. KREPS. The second question: On page 55 of this little study, Factors Affecting Volume and Stability of Private Investment, there are some recent figures just released by the Department of Commerce.

You mentioned the figure of 12 billion which you indubitably took from the last column, for 1948, which is 12 billion.

Now let me read some other figures.

Of that amount, the increase in private insurance and pension reserves was 3.51 billions.

I take it that your figure at the bottom of page 2 of your mimeographed statement, 6.9 billion, represents total premium payments rather than total savings.

Mr. SHOLLEY. That is a Securities and Exchange Commission figure.

Mr. KREPS. Premium rather than total savings. So, it is not deductible from the 12 billions. The figure of 3.51 billions is.

The increase in equity in nonbusiness real property is 2.51 billions. The increase in equity in unincorporated enterprises other than farms is 3.40 billions.

Just taking those two—and incidentally the 12 billions does include farmers—but just taking those two, you get an increase in equity of nearly 6 billions or 1.91 billions in excess of the amount that you seem to regard as necessary. Of course, if you include in addition the increase in equity in farm enterprises, you get another 2.25 billions.

In other words—and our studies show this emphatically—the Government is going into debt, horribly so, and remaining in debt, but business enterprise has never from the point of view of equity versus debt got as large a percentage of total personal savings into equities as it did in 1948.

At the bottom of page 4 you say:

> The taxpayer with a small income who now pays 20 percent would pay no tax on dividend income. It is evident that the benefit is increasingly important to lower-bracket taxpayers.

The most recent figures of the Treasury Department indicate how relatively unimportant dividend income is to those in the lower income brackets. It follows, of course, from your own figures, that only 8 percent——

Mr. SHOLLEY. I would like to make it more important.

Mr. KREPS. We all would like to make it more important.

Mr. SHOLLEY. Yes.

Mr. KREPS. But at present even in the nine to ten thousand dollar bracket, the total adjusted gross taxable income for 1946, the latest figure available, is $1,588,000,000, of which $88,478,000 is reported as dividend income, or a little over 5½ percent of taxable income.

There are large numbers in the bracket around $10,000 who own some securities. Why do they not invest more in common stocks? I think a good research project ought to be undertaken.

I believe you said that according to the Treasury estimate of the loss of revenue involved, your sales program would cost 1.4 billions annually, a gamble which might conceivably yield something like an additional 2 or 3 or 4 billions. That is a pretty heavy loading charge.

Here are some things that might be worth looking into:

If small investors do not invest more in equities you may find several reasons which ought to be examined with care.

It may not be because they do not know the stock market. It may be because they knew it too well. They may have memories.

It may be because they have so small an amount to invest that they cannot risk loss of all or part of principal. Tracing the ups and downs of stock prices they see capital values fluctuating rapidly. They have to liquidate precisely at times when stocks are low in price, namely, some period of unemployment, depression, and liquidation.

It may be because when they think of buying stock in a new enterprise they discover certain retirement clauses attached which just as their security price rise becomes nice and interesting, keeps them from further benefits.

It may be because when the stock market public relations people come out to a small town—these small investors urged to buy stocks wonders: What are they trying to do now? Unload? Distribute? Why do they want to sell? If they are getting so large a return on market price or the price they paid, why should they want to deal us in?

As I say, I do not know what the facts are, but a small fraction of the sum you mention, 1.4 billion would more than adequately finance a research project that would provide definitive answers.

The CHAIRMAN. Perhaps he does not want it.

Mr. KREPS. Maybe he does not want it, I do not know.

But I would say with less than half a million dollars an excellent research project could be set up which would really give facts why these small investors do not invest. And I can assure you that from the experience we have had with a certain type of tax credit now available, the tax relief palliative might not bulk large in the picture—I saw some figures the other day on bonds. As you know, you can get tax credit if you have bonds and fill out certain forms. That takes a good bit of time. You can get tax credit for it.

It seems entirely possible that less than 50 percent of the persons that own only one bond—not the big accounts, of course, the banks and the rest—but I mean here the investors that have just one bond, say Southern Pacific 4½, '69, less than half of these stop to fill out the forms and get the tax credit.

Of all the venture enterprises I have seen I must compliment you for what seems to be the most venturesome enterprise yet suggested, one most hazardous and not at all sure of its returns or its results.

Mr. SHOLLEY. May I correct the record here? I am not proposing this as a survey or as an educational project as such. I believe that it is an incentive. And apparently you, sir, have a different opinion of its effectiveness than I have.

Mr. KREPS. I am looking at the facts, what they might be. Frankly your proposal looks like a tax relief project for those in the higher income tax brackets.

Mr. SHOLLEY. It is not proposed as such.

Mr. KREPS. I notice you did not make that study. But I wish you would submit figures to indicate how much it might mean in the way of dollars.

Mr. SHOLLEY. If we are going to assume that our distribution of equity ownership in this country is going to stay at its present extremely low level and maintain the status quo, I will agree this proposal will have failed.

I am not under any great misapprehension of the imbalance that exists today and the hope is that we will correct that and you will get a very much larger proportion of ownership in the hands of the American people, and those particularly in the lower income brackets.

Mr. KREPS. I share that hope.

Mr. SHOLLEY. I think that is the salvation of our system of free enterprise, and that is my sincere purpose in proposing this idea. We may differ in our opinions as to the effectiveness.

Mr. KREPS. It holds very little inducement to precisely the people you want to affect most. It holds a good deal of inducement to the people getting over $50,000 a year who, after all, do not get a large fraction of total income.

The CHAIRMAN. That merely is saying that those who get the most dividends would, of course, get the largest credit. There is no doubt about that.

But I understand the witness to feel with respect to them it would release capital which now goes to the Government and which might be available for equity investment. But with respect to those in the lower group, it might to some extent educate them in the possibilities of getting dividends and thereby arouse their interest in equity capital.

Mr. Sholley points out, on the basis of the Federal Reserve study, that out of every 100 families 92 families have no investment at all. But also in response to some other questions that were asked, it was your testimony that this device would not meet the blank wall which you mentioned at the outset and that will have to be provided in some other manner.

I am inclined to believe that Dr. Kreps was making a very good argument for a bill that the chairman of this committee has introduced over and over again to provide national standards for national corporations, in the belief that if such standards were established that would do more than any other one thing that we can do to restore the confidence in equity stocks which was lost when the big depression hit us back in 1929.

Are there any other questions?

Mr. KREPS. I had one more I would like to ask, Mr. Chairman.

The CHAIRMAN. All right.

Mr. KREPS. The petroleum example you gave is an interesting one and suggests by analogy something in the nature of accelerated depreciation. That provides stimulation on the demand side, doing something to people that are putting the money into plant, equipment, property, or elsewhere, and giving them a chance to recoup their capital. It has no analogy to your proposal which merely provides more funds on the supply side.

Mr. SHOLLEY. I intended it to demonstrate it has provided a very adequate amount of risk capital for that particular purpose, and it is there because it is a tax incentive.

Mr. KREPS. It is rather saying that the people who are using capital in the petroleum industry tend more quickly to use it because of this incentive, and that there would be other people who would use it more quickly in other industries. There is the same difference here that there is between a consumer and a producer.

What you are saying is that the consumers of capital would be stimulated thereby to replace their given equipment a little more quickly if they had the chance for accelerated depreciation. You are quite right; that is a sound observation. But that it is a different facet of the investment problem, though a very important one.

The CHAIRMAN. Mr. Sholley, we are very much indebted to you for your statement here.

Mr. SHOLLEY. Thank you for hearing me.

The CHAIRMAN. I think it has been most productive.

The witness for tomorrow morning is Stanley Ruttenburg, director, department of educational research, Congress of Industrial Organizations.

The committee will stand in recess until 10 o'clock tomorrow morning.

(Whereupon, at 4:35 p. m., the committee adjourned, to reconvene at 10 a. m., Thursday, December 15, 1949.)

VOLUME AND STABILITY OF PRIVATE INVESTMENT

THURSDAY, DECEMBER 15, 1949

Congress of the United States,
Joint Committee on the Economic Report,
Subcommittee on Investment,
Washington, D. C.

The subcommittee met, pursuant to adjournment, at 10:45 a. m., in the caucus room, Senate Office Building, Senator Joseph C. O'Mahoney (chairman) presiding.

Present: Senator O'Mahoney (chairman).

Also present: David Scoll, special counsel to the committee, and Theodore J. Kreps, director of staff.

The Chairman. The committee will be in session.

When the committee adjourned last night the Chair announced that Mr. Ruttenburg, of the CIO, would be the witness this morning. He was expected to appear here to testify with respect to the general subject of the committee's hearings.

For several days, if not weeks, the Chair has been hearing reports of an increase in the price of steel. These reports came from sources within the steel industry. They were published in the Iron Age, for example, and other journals which are in touch with developments in the industry.

I asked the staff to gather such materials as were appearing in the papers for my consideration in order that I might have the opportunity of calling the attention of the whole committee to what was transpiring or apparently about to transpire.

As it happened, last evening I was called upon the telephone by the representatives of some of the press associations and told that United States Steel, through Mr. Fairless, had announced that United States Steel would make a price increase on Friday of this week. I expressed the opinion to those representatives of the press with whom I talked that on the record the steel industry, because it is enjoying the highest profits in history, practically, is not justified in my opinion in levying a new tax upon the economic system of the United States.

We should not deceive ourselves; an increased price of steel at this time—at a time when all trade and industry are fulminating against the possibilities of a tax increase by the Government to enable it to carry on its international program—would be a tax upon our whole system. It would interfere, in my opinion, with the whole objective of economic stabilization both here at home and in the international field.

I have just dictated a release upon this matter, including some of the figures which are available to anyone who cares to read the industry press.

The delay in calling the committee into session this morning was occasioned by the fact that a paper was presented to the committee last evening, late last evening, on behalf of Mr. Ruttenburg and the CIO to be delivered by Mr. Kassalow. As it happened, no member of the committee and none of the staff had an opportunity to see that paper last night. And it has been our universal rule to examine the testimony of all the witnesses in advance, not for the purpose of censorship at all, but merely for the purpose of making the hearings objective and constructive; so that questions which were to be addressed to the witnesses would be based upon a complete understanding of what was stated.

It appears from a reading of the statement of Mr. Kassalow there is some reference in that paper also to this incident of an increased price of steel.

As it happened, however, I understand from the witness that that reference came without knowledge of the action of United States Steel.

This Joint Economic Committee over a year ago had the representatives of the steel industry before it when there was a previous increase of price. I think it was the universal belief of the committee at that time, as indicated by the statements of its members during the hearing, that the increased price of steel at that time was not warranted by the facts.

I cannot avoid myself expressing the conclusions that the leaders of the steel industry in making an increase at this time are utterly overlooking the basic need in the United States and in the world of stabilization of the economy. It will do no good to the United States Steel Co. or any other steel company to try to preserve its own security if by so doing it should touch off another chain reaction that would bring about inflation, and with inflation weaken the capacity of the United States to establish permanent peace in the world.

Mr. Ruttenburg, if you will bring forward your witness, we will proceed with the hearing.

STATEMENT OF EVERETT M. KASSALOW, EXECUTIVE SECRETARY, CIO FULL EMPLOYMENT COMMITTEE, ACCOMPANIED BY STANLEY RUTTENBURG, DIRECTOR, DEPARTMENT OF EDUCATIONAL RESEARCH, CONGRESS OF INDUSTRIAL ORGANIZATIONS

Mr. Ruttenburg. Thank you, Senator O'Mahoney.

Mr. Kassalow, who is the associate director of research for the CIO and also executive secretary of the CIO Full Employment Committee, will present a statement on behalf of the CIO.

I think I should like to emphasize, before he starts, the point which you made. Our reference in this testimony to the steel price increase was made prior to the time that the United States Steel made its announcement and was based on our part solely on reports which we had seen in Iron Age and Steel and other magazines and the regular newspaper press.

And on the basis of those statements prior to the United States Steel statement we suggested that this committee investigate any suggested price increase. That is contained in our statement, and when

Mr. Kassalow gets to it, it will be perfectly evident we were not attempting in any way to dupe the committee.

Thank you very much.

The CHAIRMAN. Proceed, Mr. Kassalow.

Mr. KASSALOW. At the outset, on behalf of CIO, let me thank the joint committee for this invitation to us to appear as witness today. We should also like to congratulate the committee and its staff for scheduling investigations of such critical problems as fiscal policy, investment, and low-income families.

There has been too much of a tendency to take the Employment Act of 1946 for granted. These hearings should help to dispel some of the complacency about the present state of our economy and, at the same time, shed light on these very important subjects.

We have developed our testimony on this subject in several parts. In the first part, we make some general observations about the role of investment in our economy.

In the second section we move on to some of the more specific investment issues such as depreciation, equity capital, and taxation that have been raised during the past few years as well as in these hearings.

In the final part of the testimony we comment briefly on the proposals to help provide more long-term capital for small business.

GENERAL OBSERVATIONS

After sifting the testimony already produced at these hearings, as well as much of the literature that has been published about investment and sources of capital in the past year or more, we have been driven to the conclusion that the thinking about this question has taken a very narrow and myoptic view of economic history.

We do not mean to depreciate the importance of investment. It is, of course, perfectly obvious that no economy that wishes to grow can overlook the vital element of capital formation. But we certainly do question the kind of emphasis that so many have been giving to it.

We shall indicate why we feel this way about this phase of the subject at length below. Suffice it to say for the moment that in an economy where gross private investment, the economists' over-all barometer of capital formation, reached $45,000,000,000 in 1948, or three times the dollar level of 1929, the problem is by no means simply one of broadening and deepening the channels of investment.

Indeed, it is less than one short year since the Council of Economic Advisers, in its annual report, pointed to the fact that private capital expenditures were running at 15 percent of the Nation's economic budget. The Council report went on to suggest that—

> more sustainable long-run patterns will require a relative decline to about 11 or 12 percent of the Nation's economic budget, though perhaps a moderate increase in absolute amounts.[1]

These calculations were apparently based upon past and foreseeable future trends in output, productivity, and general economic growth.

So to repeat, it is well not to slip into an unbalanced view of this picture.

[1] Economic Report of the President, January 1949, p. 62. Actually, revised data on gross investment and national product published this summer indicate that the 1948 figure was over 17 percent.

We recognize, of course, that the temptation to place such great emphasis upon investment as the central balance wheel of a high-production economy comes easy. For like others who study the way our economy works we have, of course, been struck by the close correlation betwen previous high points in the business cycle and what the economists call gross private investment. In 1929, for example, when our total national product reached an all-time peak of nearly $104,000,000,000, gross investment rose, in turn, to nearly $16,000,000,000. By the same token, the 1948 peak national product of some $262,000,000,000 was accompanied by a record gross investment flow of $45,000,000,000.

Now, as we see it, no one can dispute these facts. But, we find that it has become all too fashionable in many circles to go on from these agreed-to facts to some conclusions about the economy, profits, and investments which are quite unwarranted.

Picking up the argument that high levels of national income have been a byproduct of record levels of investment in the past, many busines groups in the country, for example, have tried to draw the general conclusion that the only way to maintain prosperity is to push investment along continually at very high levels. This argument leaps to the next conclusion that profits must also boom along at the highest possible levels. Very high levels of investment won't be forthcoming unless there is the prospect for higher profits and, moreover, it is the groups that share in these profits that do the investing, to a very great extent.

It is somewhere in this phase of the problem that we believe many of the general contentions about investment and its characteristics break down. It is quite true that high levels of investment and high levels of profit in the past have generally coincided with high levels of production and employment; but, by the very same token, past history has demonstrated that such profits and such investment are no sure road to continued high levels of output.

In 1929, for example, corporate profits after taxes hit what was up to that time an all-time peak, but this very high level of profits proved to be no guaranty that either investment or total production would hold up. Indeed, as we know, after 1929 the economy hit a slide and we swept into a depression in the thirties.

Let me comment here that the current arguments that the welfare state, Government spending, Federal deficits, and double taxation, which are said to be choking off venture capital,weren't at hand in 1929 and the early 1930's. They were also unavailable during earlier American capital panics. The year 1948 proved to be similar to 1929 in at least one important aspect as corporate profits after taxes reached an all-time peak, but gain proved no guaranty that either production or investment would or could be sustained in 1949.

Moreover, as we take a longer view of the situation we find that investment always seems to be a tremendously fluctuating element in our economy. Over the past 20 years, for example, it has varied from a high point of $45,000,000,000 in 1948 to less than $1,000,000,000 in 1932.

Surveys of businessmen's plans for the next 5 years, made by McGraw-Hill, point to a drop from the 1948 high point in business plant and equipment spending of as much as one-third over the next few years.[1]

If our economy must pivot upon investment to such critical lengths, then we are, indeed, faced with inevitable instability and ups and downs in economic activity.

Actually it is not surprising that business investment fluctuates so sharply. What seems to happen is that at the high points in economic booms, profits pile up and business investment spurts ahead. Eventually, industrial capacity is built beyond so-called effective demand.

In other words, the consumption side of our economy fails to keep pace with its productive ability.

At this point many industries are confronted with the problem of excessive capacity. This adds to the already slowing-down rate of business investment, and the downward trend of the business cycle is intensified.

In contrast, then, to the general business theory that prosperity depends basically upon high profits in order to encourage high investments, it is increasingly clear that lasting prosperity depends first and foremost on broadened and rising consumption levels. For, as we see it, consumption can be expanded indefinitely and by its very nature fluctuates far less sharply than investment. Rather than depend upon a high investment economy, which past experience indicates cannot be sustained indefinitely, we must work and plan for an ever-higher consumption economy.

There is one more general line of thought we should like to throw out for this committee's attention.

Over many decades the output of our economy has grown at a rate of about 2½ to 3 percent each year. This is the over-all record, of course, as we know that in some years there was actually little progress, while in others these figures were exceeded.

The CHAIRMAN. What you are saying, I take it, is the elementary fact that there can be no investment, and certainly no expanding investment, without a market in which to dispose of the products of the investment. So that the relation of investment to profit is second to the relation of investment to purchasing power.

Mr. KASSALOW. That is right.

Now as you study these figures on output or, better, productivity, in connection with investment, curious problems crop up. Between 1929 and 1939, there was almost no new capital formation. Yet when we hit the defense and early war periods, in 1941 and 1942, our economy poured forth a veritable avalanche of goods and services. All this in spite of the negligible new capital formation in the thirties.

The new, war-built facilities, incidentally, didn't really begin to play a significant role until 1943 or so.

Now it is undoubtedly true that what was from an accounting viewpoint mere depreciation capital spending in the 1930's actually added to and improved the existing plant and equipment. But, keeping to the main problem, it also seems probable that the tremendous investment in plant and equipment in the late twenties left us with overbuilt facilities—overbuilt, that is, in the sense that consumption couldn't carry off the full product for any length of time in the thirties.

[1] Business Needs for New Plant and Equipment, 1949–53, McGraw-Hill's Department of Economic Surveys.

This kind of spurt and halt, and eventual readjustment between investment on one hand and employment and consumption on the other hand, isn't confined to the 1929–41, or if you prefer 1929–48, period. As this committee doubtless knows, the pattern of intensive investment followed by a bust and then a recovery and full utilization of capacity is written over and over into much of American economic history.

Yet in spite of the real dearth of new investment, over approximately half of the typical business cycle, we come back to the fact that the over-all annual increase in man-hour output of 2½ and 3 percent, and indeed the output of the entire economy, has nevertheless been sustained.

Now, it may well be that as a people we are terribly dissatisfied with our present rate of economic progress, and indeed I would think that we all want to look ahead at least to equaling this rate and, we hope, surpassing it somewhat. But if we don't actually see the crucial problem as one of greatly stepping up the rate of increase in productivity, the emphasis on the search for more and greater investment flow is misplaced.

We beleive that a prime need is for a more stable flow of investment over the whole length of the cycle, rather than a search for substantially greater sources of capital investment.

We have already outlined our own position that a high-consumption framework might provide a more stable and successful underpinning for the economy than the volatile investment variable has in the past. It is also quite likely that a sustained full-employment environment would produce higher total levels of investment and a greater sustained rate of growth in the economy than we have ever known before. Moreover, it would avoid the sheer waste involved in the busts that typically have followed investment booms in the past.

In the event that much of what we have said may be misunderstood, let me here emphasize that we recognize clearly that any society can neglect the process of investment and new capital formation only at the expense of its own economic future. This general proposition seems so obvious that in these general remarks we felt no need to lay much emphasis upon it, but preferred to deal with some of the areas of disagreement.

Indeed, we think that the function of investment and capital flow is so important that we are opposed to the prince-and-pauper way it has been fed into economy in the past. We believe the entire economy could benefit if the investment flow were keyed to a more stable pattern.

It is for this reason that we have been disappointed that these hearings have failed to produce any suggestions on methods or policies designed to help space out investment over the entire cycle. Quite the contrary, much that has been proposed would accentuate booms and busts, as we shall later indicate. May we request the committee and its staff to give some thought to this problem of stabilizing investment. It may involve tax considerations or other devices, but we think this is a field worth studying, and in which there is already some body of data as well as experience in other countries.

Incidentally, as this committee doubtless knows, included in the data published by the Federal Government on gross private investment is the value of new private residential construction. This element of the economy fluctuates much like business' new capital outlays. While these are hardly the hearings to develop this phase of the problem, we strongly contend that the establishment of a sound middle-income, self-liquidating housing program would mark a long step to ironing out some of the kinks in the investment cycle.

In any event, to repeat our earlier position, a starting point in considering this question of investment must be an unequivocal acceptance of the implications and needs for a high-consumption economy. Without the latter investment can have no reason for being.

The conservative Brookings Institution formulated the problem rather neatly, over a decade ago:

> We found from a study of our industrial history that the growth of capital is closely adjusted to and dependent upon an expanding demand for consumption goods. * * * Fluctuations in the construction of capital goods have usually followed rather than preceded fluctuations in the output of consumption goods. The controlling importance of consumption was, however, more conclusively revealed by the discovery that the rate of growth of new plant adjusted to the rate of increase of consumptive demand rather than to the volume of savings available for investment purposes.[1]

I know some members will be familiar with that quotation, and I am sure Senator O'Mahoney is familiar with it as it appeared in an earlier report of which he is coauthor.

THE ROLE OF EQUITY CAPITAL

One can't discuss capital formation or the function of investment today without coming up against the very specific issue of equity capital. Over and over again we read in the business press that the country is suffering from a shortage of venture capital. To quote a recent publication, this shortage—

> is creating a problem which will grow more acute as time progresses.

The shortage, it continues, is—

> impeding the launching of new business enterprises; such new enterprises have in the past been responsible for the most dramatic types of economic progress. If the dearth of venture saving continues it will either frustrate all kinds of capital formation or else result in the creation of unsound and extremely vulnerable structures of capitalization.[2]

This is a serious kind of charge, and since it is being made on so widespread a basis, we in CIO have tried to analyze its implications and its soundness. Our own analysis has compelled us to conclude that this typical position which we have just quoted won't stand up.

First, as regards new ventures. The typical, small, new enterprise doesn't ordinarily get built by equity capital. The largest share of equity capital, at least formal equity in the guise of stock for public sale, is used, and for a long time has been used, primarily to finance larger types of enterprise.

The CHAIRMAN. I think that you are using an incorrect definition of the phrase "equity capital." That means only ownership capital, the capital which either makes a profit or suffers a loss. It is the

[1] Quoted from Income and Economic Progress, Brookings Institution, 1935, in Temporary National Economic Committee, Final Report of the Executive Secretary, 77th Cong., 1st sess., Senate committee print, p. 235.

[2] Capital Formation Under Free Enterprise, National Association of Manufacturers, p. 87 (October 1948).

risk capital. And, of course, any person who starts a new enterprise with his own capital, however he may have gained that capital, the minute he puts it into a business venture the outcome of which is uncertain it becomes equity capital.

Do you not agree with that?

Mr. KASSALOW. I was trying to address myself to the formal meaning. I am not disagreeing with you. Personal savings or borrowing from your family or your relatives, or what have you, are generally the capital sources for small businesses. Certainly no one could say those kind of savings are less available today than at other times—that kind of risk capital.

The CHAIRMAN. That is essentially what the evidence before this committee shows. There is a tremendous volume of savings but it is not being utilized, it is not being utilized to establish new independent local competitive business on the scale which it seems to some of us the private economy demands. And at the same time it is undoubtedly true that risk capital, sometimes even riskless capital, invested in blue-chip stocks is not as available as the earning record of the companies which sell those stocks would seem to justify.

The whole picture, as it has been presented here, is one in which savings of the people are being turned into debt capital rather than into ownership. And the consideration of the factors that make up a private economy, it seems to me, leads inevitably to the conclusion that unless we have widely distributed real ownership, ownership which is combined with management power, we will be losing what we call the free-enterprise system.

Mr. KASSALOW. Let me anticipate by saying, Senator, that in our testimony we go on to recommend assistance in the form of credit for small business. So I am not disagreeing with your general philosophy on the question.

I am not so sure—and maybe your staff can brief me on this—that the number of new businesses that have been started over the past few years compares unfavorably with other periods. There may be a little more pressing credit problem than there has been at other times. But what I think can get confused, let us say, are some of the pleas which come from equity institutional sources, confusing the question of small business and equity, formal equity in the sense of stock flotations. I do not think the typical new small enterprise ever depended upon that. I would agree with you, however, there is a risk involved in investing in small business in any manner.

The CHAIRMAN. The small enterprise, according to our evidence, does not want to share ownership.

Mr. KASSALOW. We go on to make that point also.

The CHAIRMAN. That is perfectly true.

The entrepeneur who finds what he thinks to be a new opportunity for entering business and who, therefore, invests his own savings in that enterprise, if he has confidence in it, does not want to water down his own ownership by sharing that ownership with somebody else, or certainly not by giving control of the enterprise to somebody else. So he does not want that type of equity capital which is represented by stock ownership that might surrender his control. But unfortunately he is not able to get debt capital either.

Mr. KASSALOW. Well, in the past, has not what he has gotten been a kind of form of debt capital? I mean, if you are going to use a formal definition, it is not equity capital which he has borrowed by bank loans, or borrowed from relatives.

The CHAIRMAN. To that extent that was his capital; but to the extent he put in his own savings, or savings of relatives or friends who went in with him as part owners, it was equity capital.

Mr. SCOLL. May I point out something here, Senator?

The CHAIRMAN. Certainly.

Mr. SCOLL. A great many small enterprises—I am talking about starts now—start with money, we all agree, comes from family and intimate sources. That money is most often loaned to a new corporation. If the corporation fails, of course, the money is lost. For tax purposes the Bureau of Internal Revenue treats such loans as investments. And, therefore, they are to all intents and purposes to the fellow who puts his money in risk investments and not loans or borrowings. If he succeeds, yes, then he gets it back. But if it fails, he loses it.

Now there is one other point I would like to make here.

You made reference to the fact that the statistics show a great many new formations of business. They do, certainly. They also show a fairly high rate of survivorship as compared with past periods. There is no question about that.

But in a dynamic economy we must have not only starts and survivorships, but we also have to have growth. And we are concerned here with all three of those things, and so far as our particular experience in these hearings has been, growth is one of the things which appears to be limited and circumscribed in large part by the lack of availability of funds to small and intermediate business.

You may have seen the statistics that were produced by the life-insurance companies as to loans they made. Almost no loans were under the $250,000 class.

Mr. KASSALOW. That is right.

Mr. SCOLL. From an area of institutional savings which is probably one of the largest segments of institutional savings available to business today on a loan basis.. So I merely want to point that out to qualify your conclusion.

Mr. KASSALOW. We try to get into that in a special section.

I might just anticipate by saying from an early date—the exact year escapes me, and perhaps Mr. Ruttenburg can tell me—the CIO has called for types of concessions to small business in recognition of this very problem of survival and growth, so we are not unaware of it.

In most instances, of course, small-business men are opposed to selling any common stock in their firms. They are all too jealous of their independence to risk sharing management with "outsiders."

In the case of small or medium-size firms that do want to tap the equity market, the relatively large charges, which they must pay for the flotation of common stock, are an almost insuperable obstacle. A recent SEC survey, for example, disclosed that whereas costs run on the average not quite 10 percent of the value of the issue for all flotations of common stock, large and small, for flotations of less than $500,000 each, the costs totaled some 29 percent, and for the $500,000 to $1 million class, costs totaled nearly 16 percent of the value of each issue.

To get back to the 29-percent figure, one-seventh of it, or a little better than 4 percent, can be attributed in whole or in part to SEC charges for registration, legal fees, et cetera. Over 24 percent was accounted for by commissions and discount. These figures suggest that the private institutions of investment themselves bar most small enterprises from the equity markets.

So much for the questions of small firms, which I believe we can truthfully say only rarely depend upon, shall we say, formal equity capital, to begin with.

Mr. SCOLL. By "formal equity" you mean public distribution of securities?

Mr. KASSALOW. That is right.

Mr. KREPS. You mean outside equity capital?

Mr. KASSALOW. That is right.

Mr. KREPS. Outside the owners and those in the firm?

Mr. KASSALOW. That is right.

Mr. SCOLL. In those cases you are talking about the flotation costs, those figures relate to public issues of securities. You are still confining yourself to that?

Mr. KASSALOW. That is right.

Mr. SCOLL. I presumed that is what you meant by formal equity capital.

Mr. KASSALOW. That is right.

Mr. SCOLL. That, incidentally, I might say, is brought out in the Factors Affecting Volume and Stability of Private Investment.

Mr. KASSALOW. I did not recall whether you had broken the figures down into the various cost elements.

Mr. SCOLL. No, we did not break them down.

Mr. KASSALOW. It struck me that was another significant phase of the same table you are doubtless familiar with.

I have heard the argument from investment bankers on occasion that it is the SEC regulations, and so forth, that make it practically impossible for small, and say, medium-sized firms to tap the equity market. Of the 29 percent that the SEC gives as cost data, only one-seventh of it can be attributed directly or indirectly to SEC machinery. I think that might be something about which action might be recommended.

This is only one, perhaps minor, issue in the discussion, however. There is still the contention that equity capital lies at the heart of investment and capital formation and new venture in the United States.

INTERNAL VERSUS EXTERNAL FINANCING

This, too, sounds impressive, but upon close examination doesn't stand up too well. The actual facts are that even in the decade of the 1920's, when the stock market and new flotations of equity capital were in their heyday, they provided only a minor share of the funds for buildings and equipment.

The Temporary National Economic Committee, for example, found that from 1923 to 1929, business enterprises invested on the average of 8.7 billion dollars each year in plant and equipment. Of that 8.7 billion dollars, 6.4 billion dollars or 74 percent came from funds accumulated from internal sources. These figures include depreciation and depletion figures, but even if you throw these out, the other internal funds, the retained profits, were still the major sources of capital for new plant and equipment.[1]

This TNEC study I have referred to delved into individual company histories to shed light on this situation. United States Steel, they found, for example, between 1921 and 1938, invested some $1,222,000,000 in plant and equipment. Ninety-six percent of this came from internal sources. Over the same 18-year period, Alfred P. Sloan of General Motors testified that his company had expended $770,000,000 on plant, substantially all of it coming from internal sources.[2]

The somewhat subordinate role of all outside capital and of equity capital, then, is a long-established fact.

In the post-World War II period, agitation about equity capital has reached a peak. Many experts are concerned that the equity market has supplied such a small share of the capital for new plant and equipment. Once again, we find, however, that corporations have merely been following earlier practices, and are relying on retained earnings and depreciation reserves for the bulk of their financing.

Now, maybe that's not a good situation, and indeed we have grave objections to it ourselves. But business and financial leaders have no right to confuse the issue by insisting on the all-important role equity has played or should play.

Actually there is good reason to believe that big industry pursues internal financing by its own choice. For example, testifying last year before a special subcommittee of the Joint Committee on the Economic Report which was studying corporate profits, Clarence Francis, chairman of the board of General Foods Corp., was frank to say that rather than go into the equity market his company preferred to retain earnings for expansion. He indicated it was simpler and easier. Let me just quote briefly from his statement:

> You ask the question, Why have you not paid out a larger portion of earnings and raised equity funds by sales of stock? Would not equity funds be made more attractive and presumably more saleable if investors received a larger portion of earnings? The simplest answer, I suppose, is that capital raised by reinvesting earnings in the business is costless capital.

And, again, he added:

> I have no idea what it might cost us to issue common stock. Its cost would have made it unattractive, and we did not seriously consider it.[3]

Again, please don't misunderstand—we in CIO do not believe such reliance on retained earnings is a good thing. Indeed, we believe it is dangerous in many respects. It tends, for example, to foster monopoly by placing too much power in the hands of corporate executives. As we shall indicate below, it also weakens the equity market and makes it harder for other firms to come in, where they might have otherwise used equity sources.

We would certainly argue that one of the real weaknesses in the postwar equity market stems from this deliberate policy being pursued by large American corporations of retaining vast undistributed

[1] Temporary National Economic Committee, Final Report of the Executive Secretary, 77th Cong., 1st sess., Senate committee print, p. 229.

[2] Ibid., p. 227.

[3] Corporate Profits, hearings before the Joint Committee on the Economic Report, 80th Cong., 2d sess., December 6, 7, 8, 9, 10, 15, 16, 17, 20, 21, 1948, pp. 211–212.

profits. Moreover, the practice of retaining earnings has reached its zenith in the past few years.

Just to give you an idea of the way in which this thing has been going:

In 1929, 70 percent of corporate profits after taxes were distributed as dividends. In the 1936–39 period, the proportion of earnings going to stockholders was a little larger. In 1946, 40 percent of corporate profits after taxes were distributed in dividends, in 1947 less than 40 percent, and in 1948 around 37 percent was distributed as dividends.

When you seek for reasons why the equity market hasn't shared in the general postwar boom and prosperity, don't overlook this item. This subcommittee's own print pointed out that the equity share of new capital financing in 1946 and 1947 was well in line with the greater part of the 1920's.[1]

I think that is a pretty significant factor.

We contend that if corporations had seen fit to distribute some of their largesse in 1946 and 1947, equity would not have become so difficult to get in 1948 and 1949.

So long as corporations don't pass on any fair share of their huge profits to stockholders, you can't expect too many people to get enthusiastic about the equity market.

Events of the past month or so support this view. As you know, corporate dividend payments reached a peak this fall, in spite of the fact that profits were lower than last year. The result has been an appreciable strengthening of the equity market. Only a few weeks ago, the Wall Street Journal reported, and I'm quoting:

> The flood of year-end dividends has passed its peak but it has undoubtedly been an important factor in the buying of stocks in recent weeks. It has added to yields and most of the investment buying of stocks in recent months has been based on income rather than increment.

The Journal has not been alone in this observation. I think there is simply no question but that the socially and economically unwise dividend policy of American corporations in the postwar era has been a major factor in crippling the equity market. If a larger share of these boom profits had steadily flowed into dividends, I think we might have seen a different picture in the equity market.

The economic result, too, would have been healthier. The enormous concentration in American industry would have been restrained somewhat. More equity capital would have been available for some of the smaller companies and less for the giants.

Incidentally, while the process of growth from within is an old one in American corporate history, we believe that the lengths to which it has gone in recent years calls for new policy considerations.

And here is the statement that the Senator referred to before. It is right in the context of our testimony.

At this point we should like to recommend the enactment of some form of an undistributed profits tax. We think such a measure would effect a healthy change in the dividend policy of corporations, strengthen the equity market, and also help check the dangerous growth of concentration and monopoly.

[1] Factors Affecting Volume and Stability of Private Investment, 81st Cong., 1st sess., Joint Committee print, pp. 76–77.

Coupled with an excess-profits tax on corporate earnings this might also have a salutary influence upon the price policies of many corporations which now have every incentive to price-gouge the public. Let us note here, for example, that we are simply appalled by the rumors of pending steel price increases.

Here is a situation where leading steel corporations made almost unbelievable profits in their last full quarter before the strike, and are now operating at even higher levels of capacity. Yet on the pretext that material costs are up they are getting ready to bilk the public again.

We earnestly request the joint committee to look into this scandalous situation. After all, it is less than 3 months since a Federal fact-finding board concluded that in the light of the tremendous steel profits, price reductions, not increases, were in order.

DOUBLE TAXATION

Whenever the subject of equity capital is discussed one is sure to hear this old refrain. Double taxation, that is, taxation on both corporate profits and then taxation on dividend income, runs the argument, helps to kill off potential investors in equity stock.

Now in the first place, as we have already pointed out, in 1946 and 1947 the proportion of new capital represented by equity was well in keeping with past trends, as pointed out by the committee's own print.

It seems to us that the burden of proof thereby gets shifted to those who are playing the double-taxation theme. Why wasn't it so nearly effective and operative in these years if it is such a substantial deterrent?

Moreover, it has always seemed to us that this double-taxation argument rested on a view of the average man with money to invest as a veritable caricature of an economic man—a man who would estimate corporate yields, taxes, interest payments, like a demon calculating machine. The view has him carefully assessing double taxation, bond yields, corporate-profit levels, income taxes, and then ruling out stock investment.

Now we don't as yet have much data on why people do, or do not invest in corporate-capital issues, or why they choose one type of security as against another when they do invest.

Fortunately however, the recent Survey of Consumer Finances, made annually for the Federal Reserve Board by the University of Michigan's Survey Research Center, sheds some light on these questions. Among the questions which were asked of those who had incomes of $3,000 or over in 1948 and were holding liquid assets early in 1949, was why they favored or opposed holding common stocks.

The large majority of those who replied indicated they were opposed to putting their savings into common stock. As for the reasons they gave, about half stated they were just unfamiliar with common stock. Another important reason given by some 40 percent, or so, was that it was an unsafe form of investment. About 5 percent thought it took too much money to buy common stock.[1]

But what is most significant for consideration in these hearings is that the survey fails to report that taxation, or the fear of double

[1] Federal Reserve Bulletin, October 1949, Survey of Consumer Finances, Part VI, Ownership of Automobiles, Stocks, Bonds, and Other Liquid Assets, pp. 1186, 1193.

taxation, if you will, was a deterrent. At a recent meeting where one of the directors of the survey was present, I had the opportunity to verify these figures by putting the question directly, as to whether taxation was cited to any important extent among the reasons for not investing in common stock. He replied "No."

Now, the somewhat general questionnaire on investment included in the recent University of Michigan survey may not be an absolutely exhaustive answer. Indeed, the Michigan group is making some further surveys of the problem of stock ownership. Their results should be of interest.

But, there can be no questioning the general status of the issue at the present time—double taxation is something conjured up by the professionals, and isn't a real issue in the minds of ordinary investors or potential investors.

Of course, it is possible that if some special tax consideration were thrown into the revenue code, so far as corporate dividends are concerned, some modest stimulus to investment might result.

But wouldn't this be true of virtually all forms of tax liberalization? They all would provide some stimulus for the economy. The important thing is not to lose sight of the main problems surrounding the investment issue and, incidentally, so far as taxes are concerned, not to give up on any important sources of revenue in pursuit of what at best is a near will-o'-the-wisp.

CHANGING DEPRECIATION REGULATIONS TO STIMULATE INVESTMENT

This statement is already over-long, but there are one or two additional suggestions to stimulate investment that have appeared prominently in these hearings and elsewhere, that we should like to comment upon. One is the proposal to revise present Bureau of Internal Revenue depreciation regulations as regards new plant and equipment.

This proposal has, broadly speaking, two variations. The more common one is a proposal to allow for so-called accelerated depreciation of new plant and equipment, generally down to a minimum period of 5 years.

This change in the depreciation regulations will encourage important new investment, it has been argued, and will be of special assistance to small business.

I think this small business part of the argument can be dismissed quickly. No serious evidence has been presented to show that this proposal would help any small businesses as opposed to large, well-entrenched enterprises.

Aside from its effect upon small business, I think this subcommittee might find of interest a critical analysis of this proposal prepared to Dr. Solomon Barkin, the research director of the Textile Workers Union of America, CIO, entitled "Accelerated Depreciation Would Mean Higher Prices, Higher Government Deficits and Less New Investment."

The CHAIRMAN. Your whole argument here is based upon the assumption that such a plan for accelerating depreciation would not make any special recognition of the claim of small business.

Mr. KASSALOW. Senator, when the Department of Commerce Small Business Advisory Committee made the proposal, it seemed to me they made no reservation—did they? I am not saying what might happen. It seems to me, of any of the plans I have seen thus far, for example, the machinery and allied products plan, none has made that distinction.

The CHAIRMAN. I cannot dispute you with respect to what that Small Business Committee may have done, but I can call attention to my own record, because I have introduced positive amendments to tax bills, the objective of which was to make a distinction—a legal distinction—between investment in the huge national ramifying corporations which engage in a number of different industries and produce sometimes a score of different products and the enterprise which is local in scope, which is competitive in scope, and which is devoted to a particular industry.

In other words, the question is: Is there a sufficient interest, is there a sufficient public value in a positive program to stimulate the establishment of new privately owned and privately-managed-by-the-owners industries as distinct from the collectivist institutions which now are becoming more and more dominant in the field because they are receiving practically the only assistance that comes from the savings of the people as channeled through the large institutions.

We have this curious anomaly. The testimony of the insurance industry is to the effect that the average insurance policy in the United States is about $4,800. Because that is the average, it follows that there are hundreds of thousands, if not millions, of policies of as little as a thousand dollars' face value.

The premiums paid on these little policies while insignificant in themselves, merely because of the large number of such policies, produce a tremendous reservoir of savings. And the system that we have permits those savings of the little people of the United States to be channeled into the service of the big collectivist businesses which dominate our industry.

One of the purposes of this study is to find whether or not it is possible to provide ways and means of giving access to such savings to the small competitive industry. My personal belief is that the Congress is justified in making the distinction between competitive business and the highly concentrated industries which are the dominant factors of our time and which, incidentally, were the real founders of the CIO.

Mr. KASSALOW. I sort of got lost on that one, Senator, but let me say that we——

Mr. RUTTENBURG. Who did you say founded the CIO, the small ones?

The CHAIRMAN. The big ones. The CIO would never have come into existence if we had not already had the tremendous concentration of industry.

Mr. RUTTENBURG. It does not follow from that, as I am sure you do not mean to imply, that the CIO is not opposed to great concentration in basic industry.

The CHAIRMAN. I hope not.

Mr. RUTTENBURG. We are strongly behind your proposals in the small-business field.

Mr. KASSALOW. Let me say we certainly are in sympathy with the efforts of yourself and the committee to probe for the sources of small business. It might well prove—we have never taken a position on this particular aspect of the question—that accelerated depreciation is not one of the best means that could be proposed even if limited to small business, that we have never considered it in just that limited form.

Briefly, Mr. Barkin's study points out that unless profits were sustained indefinitely at the current tremendously high levels the Government would stand to lose substantial tax revenue over a period of years, if accelerated depreciation were introduced. The loss, based on recent rates of new capital expenditure, would come to around $1,000,000,000 per year.

Moreover, tax savings for corporations under the proposed acceleration, based on profit and capital expenditure levels of recent years, would amount to less than 0.5 percent of net sales, and around 3 percent of profits before taxes. So small a tax saving would certainly not provide any real stimulus to industry for modernization or purchases of new plants and equipment.

On the other hand, accelerated depreciation would tend to increase the cost of production, bookkeepingwise, at a time when there is still general agreement on the need for lower prices. Moreover, even after the 5-year period ended, and the assets were entirely depreciated, over that large part of the American economy where administered prices prevail the price level would doubtless not be adjusted downward.

Another defense of the accelerated depreciation principle advanced by spokesmen for corporations is that it would provide additional funds needed for working capital. Suffice it to say that corporate working capital has increased over 170 percent during the past 10 years, and is around 66.7 billion dollars, compared to 24.5 billion dollars in 1939.

Let me add a few words on one other type of special depreciation pleading being peddled by a few business spokesmen, namely, so-called replacement-cost depreciation.

Many of the arguments against accelerated depreciation also apply here. Moreover, the proposal is so unfair on the face of it that it is hardly worth your serious attention. In the first place, there is the indisputable fact that replacement never takes place in identical units, so that any departure from original cost becomes meaningless. Allowing existing corporations to depreciate their fixed assets at current rather than original cost would obviously afford them enormous advantages as opposed to new corporations seeking to enter the same fields. This could be a classic method of entrenching monopoly.

Another implication which the replacement-cost advocates fail to face is that the need for increased depreciation costs really arises because existing book assets have undergone a tremendous appreciation in recent years. It would be as sensible for business to propose a capital-gains tax, based on this windfall appreciation, as it is for them to suggest replacement-cost depreciation.

The actual facts, of course, are that these properties have for a decade, now, been grinding out profits at a rate far in excess of anything that was dreamt of when they were originally purchased. These huge profits, broadly speaking, have more than offset any pressure the owners might feel when they come to replace these same assets.

I cannot refrain from calling attention to one more thrust at the replacement cost doctrine. It was made by Mr. G. B. Elwin, vice president and treasurer of the Steel Co. of Canada, Ltd., in a letter to the magazine Business Week, December 11, 1948, page 42.

He wrote, in part, on this proposal:

> * * * assuming that the fixed assets were purchased with borrowed funds—that is, assuming that the company has a sizable bond issue which was made for the purpose of financing expansion at some prior period—would you then argue that the shareholder is entitled to figure depreciation at replacement cost when, in truth, his only obligation is to return to the bondholder the same number of dollars as he borrowed in the first instance, regardless of the fact that in the interim their purchasing power has decreased?
>
> Theoretically the shareholder is in the position of having borrowed certain equipment which he has worn out through the years, and from which he has secured enough profit to pay for the equipment and have something left over for himself. Can it not then be argued that if it is going to take him, say, three times as much to replace the equipment, he can turn around and borrow that same amount and start the process all over again? In other words, would not any additional depreciation beyond the original cost which might be provided through the indulgence of the tax gatherer be an unwarranted gain to the shareholder at the expense of the bondholder?

The CHAIRMAN. Again let me point out that a fundamental distinction must be made before we can draw an intelligent conclusion on these matters, a distinction between the position of big business and the position of little business.

Now, the leaders of big business are constantly denouncing security and the desire for security and yet the managers of big business are most solicitous for their own security. I mean for the security of their particular industry. They take a very short-sighted view of security upon the part of the other fellow.

I think there is no industry that more clearly demonstrates this than the petroleum industry, where the small independent wildcatter undertakes the venture, goes out into the untested areas, and brings in the new fields. After he has brought them in, the major company buys him out, and the concentration of ownership of our reserves in the major companies proceeds.

Everybody who knows anything about the oil industry knows that the venture capital is ventured by the little fellow and not by the big fellow. Of course, I do not mean to say the major companies never take a chance, but they are most solicitous to make certain that the chances they do take are surrounded by the greatest possible security. This talk about security when the little fellow at the bottom of the economic scale is the person to be benefited, coming from the mouths of big business leaders, leaves me utterly cold.

Mr. KASSALOW. Let me say "amen" to that.

Let us make one final observation on these depreciation proposals, and it applies especially to the acceleration principle. In making any judgments this subcommittee should take care not to adopt a shortsighted position—one which, on the face of it, might have some immediate beneficial effects, but wouldn't jibe with sound long-term policy.

Depreciation charges, accelerated or not, can in the last analysis only be written off against revenues. If a company is operating at a loss, all the acceleration in the world won't avail it anything.

Once this is recognized, it should be apparent that accelerated depreciation will operate to intensify the worst features of a typical business boom, and thereby add to the depths of the usual business cycle. Firms will be encouraged to plunge ahead with investment plans at a time when peak sales and profit levels are in prospect.

It is at that stage of the cycle that the greatest advantage would accrue to corporations, in the form of reduced corporate taxes and larger real returns. Surely, from the broad economic viewpoint we would be better advised to develop policies which would encourage business investment at other than boom stages.

LONG-TERM CREDIT AND TAX ASSISTANCE FOR SMALL BUSINESS

One theme that has run through much of these hearings is the need for some new, long-term credit institutions for small business.

This is a subject to which the CIO has addressed itself favorably on several occasions in the past. Whether or not there is today a new and more pressing credit need for small businesses it may be difficult to say, but in any event this is a long-felt need, and we are in sympathy with planning to meet it.

May we suggest, however, that any proposal this subcommittee makes should have proper safeguards. If, for example, some form of loan insurance merits recommendation, we urge you to avoid setting up any gravy train, where the Federal Government will be left holding the bag.

As to just where such credit machinery should be set up, and whether some new agency is required, there seems to be considerable difference of opinion. But we strongly urge that wherever it may be set up, the new credit machinery be tied in by some means with the over-all fiscal, monetary, and credit-policy machinery of the Federal Government. If this isn't done, one can anticipate a small-business loan policy which, like much of the housing credit, would often run counter to the main stream of Federal fiscal and credit planning.

On numerous occasions in the past we have argued that changes should be made in the corporate tax laws to assist small business. Increased exemptions for small business would go a long way in helping their chances for survival and growth. Incidentally, we incline to the belief that such tax changes might well be the most tangible relief that could be afforded small business.

CONCLUSION

We ask the subcommittee's pardon for the length of this statement, but we feel the subject is not one for light treatment. Indeed, there are aspects of it which we haven't even touched. May I particularly mention in this respect the problem raised in the subcommittee's own prospectus for these hearings, namely, the flow of savings into life insurance and other savings institutions.

Certainly the enormous financial power being accumulated in the hands of large life-insurance companies is extremely disturbing. Already, the combined mortgage and corporate bond holdings of life-insurance companies, mutual savings banks, and savings and loan associations are nearly one-half of the total mortgage and long-term corporate debt outstanding at the present time as compared to less than one-third in the prewar, 1929–39, period. Needless to say of these savings institutions, by far the most significant are the life-insurance companies.

We sincerely hope this committee and its staff as well as the Council of Economic Advisers can make effective proposals to deal with this enormous concentration of economic power.

May we in conclusion urge this subcommittee to make its recommendations in the broadest possible context, and to avoid adapting policy to purely short-term needs or interests. Proposals such as granting special tax exemptions to corporate dividend payments or the institution of accelerated or replacement cost depreciation systems, as well as others we have referred to above, are not in the best interest of the Nation as a whole.

The CHAIRMAN. Mr. Scoll?

Mr. SCOLL. Some of your observations throughout your statement, I presume, are intended to be merely cautionary to the staff of the committee and through them to the committee to stick to their knitting, so to speak, of the Full Employment Act.

Mr. KASSALOW. That is right. We think it is important to couch practically all of these recommendations that way. I do not claim there is any disagreement between us.

Mr. SCOLL. You have no question in your mind that that is what we are trying to do?

Mr. KASSALOW. No; but a lot of the proposals that have been made seem to me not to be in that spirit or vein, over the past 10 days or so you have been having your hearings.

Mr. SCOLL. You have addressed yourself to the depreciation question. As the Senator pointed out, the suggestions have been made here, and those that have been under consideration have all dealt with accelerated depreciation limited in scope to benefit the type of business we have been trying to—the starts, the survivals, and those that are trying to grow. We have not considered, nor has any recommendation been made to us to allow accelerated depreciation on a general basis to all business.

Mr. KASSALOW. Wasn't the Department of Commerce Small Business Advisory Committee recommendation a general recommendation? In fact, I think they specifically stated they did not have any interest in seeing it specifically limited to small business. I think the Senator put that question to the witness.

The CHAIRMAN. I think that is right. He is talking of the recommendations that were made by the Small Business Advisory Committee to the Secretary of Commerce.

Mr. KASSALOW. Did anyone else make accelerated depreciation proposals during the week? The insurance people et cetera. Did Mr. Reed mention it?

Mr. SCOLL. It has been discussed.

Mr. KASSALOW. I am not saying you people were suggesting it on a broad scale. It seems when the suggestion has generally been made in public, it has been on an unrestricted scale.

Mr. SCOLL. Of course, you have one caveat here on the question of basis for depreciation—original cost versus replacement. That point has never been raised in the hearings, but we have been talking about accelerated depreciation on new investments; so the question would not be germane.

Mr. KASSALOW. But in your own print you pointed out that has been an issue under discussion whenever the question of investment has been raised, and you made a number of interesting citations of sources on that question.

Mr. SCOLL. What do you refer to specifically when you speak of not to give up any important sources of revenue in pursuit of what is at best a near will-o'-the-wisp? Is that referring to the depreciation issue?

Mr. KASSALOW. That was the double-taxation issue, it seems to me.

Mr. SCOLL. The only testimony we have had on double taxation that was put in extensively was yesterday, and one of the witnesses also recommended that the corporate tax be raised to cover the possible loss in revenue.

Mr. KASSALOW. I remember the Department of Commerce Small Business Committee making that one of their five points on which they made recommendations. They thought elimination of double taxation would help stimulate investments. That was part of their general program. I do not see how it would have helped their case much. Moreover, it has been an issue much agitated when this question of investment and stimulating investment has come up, if not this past week, in many of the journals. It is a standard issue.

Mr. SCOLL. You are aware, I presume, that most of our studies or testimony produced so far indicates that as far as retained earnings are concerned, they are mostly the corporations that do not have any problem about securing their new capital financing. They are the ones that have the retained earnings. The people we are concerned about, most of them do not have any retained earnings.

Mr. KASSALOW. Let me say when we make this proposal for increasing the exemptions of small corporations, so far as the corporate-profits tax is concerned, that exemption would also cover them, too, insofar as the application of any undistributed-profits tax is concerned.

Mr. SCOLL. Your statement very properly points out the paramount importance of stabilizing investment and avoiding any incentives which would tend to accelerate the cyclical swings.

Now, is it your opinion that insofar as incentives or financial aid were provided to assure survival and growth of small and intermediate business it would tend to accelerate the cyclical swings or do you want to make an exception in that respect?

Mr. KASSALOW. In our recommendations on that very question we definitely feel that any credit machinery which you do establish for small business—and we are for that—whether it is an independent agency, one of the existing agencies, or what have you, cannot be left outside the general tent of over-all fiscal and credit policy.

That would mean, I presume, in certain boom periods that particular agency, like other Federal agencies, would be more restrictive in its lending. It would still be available and be that much of a gain for small business. Then in periods of decline we would hope that the granting of credit to small business might be liberalized, particularly, but we think that it just seems unwise to leave it unregulated, because at this point nobody knows what the magnitude of this kind of spending might be.

It might be very large, and it would seem unwise to have that outside the general credit machinery and it seems to me some of the proposals that have been made sort of lean toward that.

As I recall the first day's testimony, the Department of Commerce Small Business Advisory Committee proposal would have put it pretty much on a local private bank level, with very few restrictions. And as I have said, you might get a situation there where some of the worst features of housing credit would develop in the small business field, the tendency to be very liberal when things are flush and then pull back when things are down, which seems to run counter to good Federal fiscal and credit policy.

Mr. SCOLL. Are you familiar with the so-called Kaplan capital bank plan for small business?

Mr. KASSALOW. Somewhat. It seems that proposal, as I recall it, would tie a little more closely to the over-all fiscal policy because it would be tied in to the Federal Reserve district banks.

Mr. SCOLL. It would be inside the Federal Reserve System.

Mr. KASSALOW. We have not as yet determined in our own minds what should be done, whether it should be capital banks or through the regular banking system with a loan insurance feature; but we do think it is important to keep this thing within the broad framework of general fiscal and credit policy, whether you put it under the Federal Reserve Board or RFC or the Treasury Department.

Mr. SCOLL. There is still another question about this type of financing, and that is the question of whether or not the assistance should be in the form of direct Federal help in the form of insurance or, on the other hand, whether it should be done through a franchise system within the existing banking and financial institutions.

Have you any position to take on that? The Small Business Advisory Committee, as you know, came out strongly for a direct Federal aid plan in the form of insurance. The Kaplan plan is not such a plan. Do you care to state your position on that?

Mr. KASSALOW. It is just possible, and it is really hard to tell, that the small-business fear of something like—maybe unexpressed fear—that something like the Kaplan plan might be overconservative so far as they are concerned. I suspect that is why they want it put outside some of the existing Federal institutions.

But, quite frankly, we do not have any worked-out final position on that question. I would assume that when and if a recommendation is forthcoming, there will be specific legislation drafted, at which time there will be hearings, and it may well be we can have a specific position on it. We have not seen enough discussion and have not had enough discussion of it among ourselves yet. We are aware of some of the issues, but do not pretend to be that expert.

Let me add it is possible that if you had a capital bank plan such as Kaplan and others have proposed and had it maybe more subject to pressure from the central banking system, then the dangers that it might be too conservative or not favorable enough to small business might be circumvented. That is a pretty difficult issue to answer.

Mr. KREPS. I have one or two questions. I could not judge from your testimony on the matter of the survival and starts of small business whether you thought the story today was or was not different from that in 1929, or was or was not more favorable. Specifically the question is this:

We obtained from the Department of Commerce a study on the current position and financial problems of small business, which is printed as chapter 5 in our study. In that they say at page 119:

> The long-term trend figures show that the number of firms and thus presumably the number of small firms has increased more rapidly than the human population

since 1900. Thus, in 1900 there were only 21 firms per thousand persons, but in 1947 the number of firms per thousand persons has increased to 26.

Then they give a table, make comparisons between 1929 and 1947 and go on to say:

> All major industry groups except finance, insurance, and real estate, showed an increase in the business population in excess of the human population.

This has been further broken down by individual industries as opposed to industry groups in a compilation which was not then available, but has since been made and handed to us, on the basis of revised estimates of business population. I ask that the table, prepared by our staff, be inserted at the conclusion of Mr. Kassalow's testimony.

It would tend to bear out for a number of individual industries the same over-all tendency. Now, is it my understanding that you question that analysis?

Mr. KASSALOW. No. As a matter of fact, when the Senator put a question to me, I asked him whether or not the number of business starts was not favorable so far as indicating that—let me go back a bit.

In our testimony is the statement that we are not sure that the problems of small business, new small business, if you prefer, are greater or lesser today than they were at any other time, but we have recognized that they have had serious problems for a number of years and have argued for something like tax relief and something like long-term capital relief for a long period of time; so that regardless of what these figures might show, unless they were very extreme, we would still be for it and have been for it.

So far as some of those figures are concerned, it is pretty difficult to judge them. You are more familiar than I. You never know to what extent satellite companies have sprung into existence as against the real powerful companies in the industry. I would assume generally, however, that in a period such as the past 10 years you do have a favorable environment for the establishment and progress to some extent of small business. In the up part of a business cycle that is usually true, I think.

In fact, small business as a group probably has more at stake in maintaining full employment and sustained levels of employment than large business, relatively speaking. I would not quarrel with those figures.

I think that the need is there and it is recognized, and whether the figures would support it one way or another would not be——

Mr. KREPS. There has been a small business problem for a considerable time.

Mr. KASSALOW. That is right.

Mr. KREPS. And while the situation, particularly after this war, has not been less favorable to small business than in the past, your judgment would be——

Mr. KASSALOW. Their competitive position in some ways is worsened by the retained profit practices of their large competitors; so even though they may be better in some respects, in that competitive sense they may have been at a disadvantage, but in any event, I think the problem is a real problem and we certainly support the efforts of this committee to try to find the solutions to it.

Mr. KREPS. I have one other question. It concerns the types of analyses that bear on the problem of stabilization of investment. I am indebted to you for the observation that though we have been talking about stabilization, the proposals thus far made for the most part have been proposals to increase the amount of investment. There have been none indicating when investment might be in excess of a long-run amount that could be sustained.

Mr. KASSALOW. We fall into the same attitude. In a period of what seems to be sluggishness or some decline from the high levels of 1948 we all, I suppose, tend to think of some way to stimulate the economy to get back to the earlier level, but that gets back to our general feeling that we hope this committee will try to take as broad a view as possible. It may well be that 1950 will be more of a boom year than 1948, and you may be faced with an inflation threat. We do not quite look for that, but it is a possibility.

Mr. KREPS. That problem was raised by this committee yesterday with Mr. Reed. In general no real method was offered whereby to detect so-called excessive investment. His proposals in every case were proposals to increase the amount of investment.

I note you urge us to look at methods of stabilizing investment; and, since we have a large number of proposals indicating how investments might be increased, do you have anything in mind that you regard as highly useful for judging whether at certain times investment is at a level which the economy can sustain; and, secondly, do you have any specific proposals concerning what either business or government might do?

Mr. Reed came up with the suggestion that there were certain postponable business expenditures that certain large businesses, I judge, might postpone until a period of depression, although he did go on to say that this might be difficult to put through.

Mr. KASSALOW. Let me first state that if we had the machinery or mechanism—and that is part 2 of your question—I think someone could have made a judgment, let's say, no later than the latter part of 1946, when it was pretty apparent that we were in an inflation upswing, that these methods, whatever they might be, should now come into play, and we might have tapered off some of the tremendous business investment and business construction program of 1947 and 1948, tapered it off to good advantage to the extent that it might have been available in, let us say, 1950 and 1951.

Someone would have to make that judgment, I presume, maybe the President. I rather think that possibly the joint committee in conjunction with the Council at some point, if we had the machinery, might make the recommendation to Congress. It would still have to be passed by Congress. When I say it would have to be acted on by Congress, I am thinking of the fact that the only kinds of proposals I ever heard—and I do not pretend to be too familiar with them—are some manipulations of tax rates.

I think that in Sweden, for example—I am sure your committee can get this better than I have it from just recollection—under certain circumstances business firms are given tax credits for postponement of certain types of capital expansion. In other words, part of the tax on corporate profits is held more or less in abeyance; and, if they postpone their capital expenditures for a certain period and then do go through with the spending plans 2 or 3 years later when the green light is given by the Treasury Department, they receive certain tax credits; either their succeeding taxes are reduced or they get certain refunds.

I think Dr. Colm, of the Council of Economic Advisers, had several articles on this a number of years in the Journal of Social Research. He worked out, I recall, a definite plan which would have set up some of the machinery which would show how in certain periods part of a corporation's tax payments would be held in escrow or a book credit for it in the Treasury Department; and, if it did certain things in succeeding years or did not do them, there would be a refund; some advantage would be given to them.

It is an enormously complicated problem, and in throwing it out I was merely hopeful that either the Council or the joint committee could devote some attention to it.

Mr. KREPS. You propose a type of solution that is somewhat unpalatable. I would like to see corporations and trade-unions and others devote their own research to this type of problem. Rather than getting things done by governmental action, I greatly prefer getting them done by voluntary action.

I judge from your answer that thus far your research activities—despite the enormous interest you have in this problem of stability because one of the primary sufferers of depression is, of course, labor—have yet not arrived at even tentative or approximate answers. Maybe you have not devoted time to it.

Mr. KASSALOW. That would be more correct. We are increasingly interested in this and hope to devote more time. We have had some preliminary discussions with a few people, but we are at the start of our own research.

Mr. KREPS. The problem is one of getting the benefit of research activities of all organizations, including yours, with the hope that they will come up with proposals which will involve the very minimum of Government action.

Mr. KASSALOW. Yes.

The CHAIRMAN. May I call your attention to page 9 of your paper, the second paragraph from the end:

> In 1929 70 percent of corporate profits after taxes were distributed as dividends; the 1936 to 1939 period the proportion of earnings going to stockholders was a little larger. In 1946 40 percent of corporate profits after taxes was distributed in dividends, in 1947 less than 40 percent, and in 1948 around 37 percent was distributed as dividends.

What is the source of those figures?

Mr. KASSALOW. Let me just check. I think probably the Survey of Current Business. I do not know if I have marked my sources right here. Has someone checked those figures against the GNP of the Department of Commerce?

The CHAIRMAN. I think it may be something of this kind was in one of the economic reports. I think it is well to get the source defined for the purposes of your statement, too. Of course, it is part of the story of retained earnings, and it may be part of the explanation of the lack of equity capital if it is generally known that the large, mature, well-established companies are not distributing their earnings to their owners and giving only a portion of it. The owners, the people, who have savings, may be less desirous of putting money into such enterprises.

Mr. KASSALOW. I would think, Senator—I would like to make the calculation back in my office—but the national income supplement to the Survey of Current Business has in table 19—there you have corporate profits after Federal and State taxes, and then on table 20 is net dividend payments by industry; and, as I recall, it was a division of one by the other. There may be a misprint.

The CHAIRMAN. Suppose you check it and furnish us with that.

Mr. KASSALOW. For the moment I think it is the Survey of Current Business of the Department of Commerce.

The CHAIRMAN. Check it in your office and let us know, and I will ask the staff to make a check.

Mr. KASSALOW. I think that is the only source.

(The information referred to above was subsequently supplied by the witness, as follows:)

During the course of our testimony of last week you asked us to furnish you the source of our statement concerning corporate dividends as a proportion of corporate profits. I believe that you can find the original data from which our figures were adapted in the national income supplement to the Survey of Current Business, July 1947, tables 19 and 20, pages 32 and 33. In addition, we also consulted the national income number of the Survey of Current Business for July 1949, tables 19 and 20, page 17. This publication, as you know, is issued monthly by the United States Department of Commerce.

The CHAIRMAN. Mr. Scoll, do you have anything further?

Mr. SCOLL. I have no further questions.

The CHAIRMAN. Do you want to make any comment about the next witness?

Mr. SCOLL. We have no further witness this morning.

The CHAIRMAN. I see.

Mr. SCOLL. The Investors League, Inc., had requested an opportunity to appear this morning, and we had hoped that we would have time to hear them, but since that was not possible they have submitted their statements for the record. They will be available and will be given very careful consideration.

(The material referred to above is as follows:)

STATEMENT BY ALLAN M. POPE, PRESIDENT, INVESTORS LEAGUE, INC., BEFORE THE JOINT COMMITTEE OF CONGRESS ON THE ECONOMIC REPORT, DECEMBER 15, 1949

I am Allan M. Pope, president of the Investors League, Inc.

The Investors League is appreciative of the opportunity to appear before this committee.

It is important that the incentive that brings the Investors League before you be briefly stated. We are a group of several thousand investors at the point of making a very great increase in our number from thousands to tens or even hundreds of thousands. There are millions whose interest we represent even now. Anyone who directly or indirectly invests, for example, in securities of any kind, in a business of any size, or in a pension or retirement plan, or in an insurance policy is an investor and has a financial stake in the future of America. There are far more investors in the lower-income brackets than in the higher. Obviously our membership does and will always reflect that fact.

I am about to speak to you on the lack of equity capital. That statement must be qualified, for the public is and has been interested in the equities of large, successful corporations with long records as dividend-paying organizations. With very minor exceptions, such shares have been underwritten and successfully distributed for years. Whether in the recent past the heavy demand for such equity money would have glutted the markets had not corporate earnings been plowed back into improvements and additions and had not earnings been extremely high, is a question probably to be answered by saying that rebuilding an industry would probably have cost far more and would have been long delayed had all equity been sought in the open market. We may be facing this long delay directly ahead of us when we can least afford to wait. (Article 102 and inadequate depreciation reserves will be referred to by others.)

There has been a steady increase until now in the formation of new small industries due to several causes, mostly transient, as, for example, the loans to veterans to set up their new business ventures. This is largely Government subsidy.

It is therefore a mistake, as a general rule, to say equity capital has been lacking. For some special classes of small industry it has been, but generally speaking we have been relatively well supplied. It is in the future where the real trouble lies. Equity capital for new ventures is going to be scarcer—much scarcer.

So I will begin by saying that we must have assistance, some of it from the Congress, in changing the attitude of far too many in this country who have been led too often to believe that successful people must be subject to suspicion, that businessmen who operate corporations are enemies of some sort. There has arisen a degree of class hatred never before known in our country. Since such thoughts became more and more prevalent, there has been an unfair and unwarranted feeling toward business executives and business in general. People of small or moderate income took such ideas seriously when inexperienced; and today, as they have increased their incomes, they have become the great group from whom must come the buyers of equities. We want equity capital, yet we will never get enough of it if businesses that use it and need it are improperly belittled or berated.

The man with large net income is disappearing—the rich man. More often than not it was he who invested in the new enterprises that now are old; and he did it when he was not a rich man; or, if he did it when rich, it was because he had had experience in venturing when poor. The man with large net income is, I say, disappearing as an investor in venture capital. You have heard time and again at these hearings and before that he is being taxed into complete uselessness as an equity buyer. Who takes his place in the future?

While it is true that over the years Congress has taxed certain former equity money out of existence, the worst is that now we are gradually but surely changing our national character and so aiding in limiting our future supply of equity money. The venture is being taken out of American life and so we are breeding a riskless people that demand security first and the opportunity to work for it second.

We have been led to believe by too many that financing new undertakings is speculation and that those that speculate have something wrong about them—they are some kind of an enemy, not to be trusted. Not only have we encouraged our people too often to believe such things but also we have led them down the path of personal security to the extent that any risk now is frightening to them. Too often we want our financial future securely guaranteed by a benevolent government and as a people we have not yet seen the horror that awaits us when we overdo it. We are slowly but surely reaching that point.

The more such a feeling grows, gentlemen, the greater the risk becomes that we will ruin ourselves by becoming a nonventuresome nation. We will some day wake up with a shock, when we suddenly realize the fact that there is no such thing as complete security for anyone and never has been. Then we will find ourselves adrift on an insecure sea with no practice in swimming alone and with a life preserver that floats only on bubbles of froth and foam.

Let us work for what security we can find. Let us work that our neighbor in want and our parents and grandparents in their old age may be aided. but first let us venture afield that business may expand and employment may be abundant otherwise we cannot do this very thing.

We contribute to our own security plans when we insure our lives and save money. Why should it remain so universal a custom that conservative fiduciary companies invest only in bonds and mortgages—interest bearing securities—on the thory that it is safer. Management is correct and it is not subject to criticism. However, it cannot be lacking in conservatism to consider how after years upon years of mounting prices the dollar conservatively invested by conservative men for conservative people always comes out smaller than when it went in. Are gilt edged stocks more dangerous and less conservative as an investment today than bonds that are not and cannot always be as gilt edged if diversification is to be maintained.

It is the trend of thought of the times that impels such consideration. Let it not be thought that it is the business of the Federal Government to legislate what such companies shall purchase. It, however, is the business of the Federal Government to reverse any policies that encourage undervaluing the importance of owning our industries and to increase the extent of those policies that create confidence in business and properly popularize increased ownership in them. The businessman that has acquired enough to invest his own funds in marketable securities almost invariably buys stock for the purpose of owning outright a part of that type of business that he feels will keep on going, making more dollars when each dollar buys less. Such a man has had more business experience than the man in the lower income group, so he buys equities because the one thing he feels is likely to be ahead of him is that kind of inflation that raises prices of goods and services and lowers the purchasing power of his dollar. As long as the Government has not made any substantial effort to change this trend or been able to change it the prudent businessman does for his family what the ordinary fiduciary company does not do for him.

Nobody, I believe, favors a great proportion of equity holdings by fiduciary companies, for example. If a certain small proportion of insurance-company funds were invested in high-grade equities such as most trust companies recommend for individual estates, the interest in high-grade equities would increase, because people in general would begin to have greater confidence in equities and little by little having once crawled, individuals, and some of the investment trusts, would soon walk into venture capital, the capital that builds ideas and that built America.

If investors of large sums, such as the investment trusts handle; and together with individuals of the middle-income groups do not risk anything where will be the corporations that now supply the gilt-edged stocks and bonds? Some will remain, becoming fewer and fewer in number per capita population and bigger and bigger in size.

If venturesome funds are not to be encouraged by creating greater confidence in business than has been created in the past and if such funds are wanting and are essential then they will come from the Government itself. Then new businesses will be run by the Government for the Government but with our own money just the same.

Gentlemen, the future of this country lies in the right leadership of our people. If our tax structure and our spending program are not now, and at once, better calculated to place our industrial development and our research abilities where, unhampered, our native industrial genius can put it—to the end that we can assure ourselves of our ability to lick those who defy our God-given right to live as a free and independent people—then General Groves' grim remarks may appear as a shocking red glare in our face. We can be annihilated!

The Investors League has taken direct action and has supported the Crawford bill against double taxation and hundreds of thousands of letters have been written to legislators in favor of that bill by persons who read the Bulletin of the Investors League, which has been sent to them, in many instances by some of the most important corporations in America, but, gentlemen, I have tried to explain that reduction of taxes, important a help as it is, is not the only incentive needed for putting equity money in circulation. Dean Flacker who follows me will be more explicit.

Statement of Clarence W. Fackler, Research Committee Investors League, Inc.

A four-pronged attack upon the equity-capital problem

I am Clarence W. Fackler, assistant dean of the Graduate School of Business, New York University, and a member of the Research Committee of the Investors' League.

The Investors' League, on whose behalf I am making this statement, is vitally concerned with an adequate flow of equity capital into enterprise.

The league is composed of all kinds of investors, small and large, bondholders, and stockholders. All these investors will benefit if enterprise is healthy, with adequate, well-balanced capital structures. All will be hurt if business becomes heavily debt ridden, facing financial embarrassment and inability to raise new money needed for expansion and modernization because of impairment of credit.

In other words, the Investors' League, if I may be so bold, can be said to have the same broad interest in the equity-capital problem as has this committee, which studies the question from the standpoint of the national interest as a whole.

I will undertake to show, in my statement, that

1. The equity-capital problem facing American business, especially smaller business, threatens to become much more serious in the future than it has been in the recent past; and

2. A great deal can be done to relieve, if not solve, this problem through suitable remedial action by the investment banking business, financial institutions, business managements, and Government.

By and large, an equity-capital shortage has so far been a potential, rather than a current problem for large and established business enterprises. The Department of Commerce reports that all business corporations required $55,000,000,000 of new funds in the years 1947 and 1948 alone. About 40 percent of this huge sum came from retained earnings, which is equity capital in its most desirable form. These retained earnings constitute, in effect, an additional investment in business enterprise made by the stockholders, without even a dilution of existing stock issues resulting.

But we would be deceiving ourselves and the public to deduce from these figures that the equity-capital problem has been solved. First, retained earnings are of no help to newer enterprises and less profitable enterprises that have no considerable amount of earnings to retain. Secondly, business profits are declining as the postwar inflationary boom comes to an end, while dividend payments are increasing. Retained earnings this year, preliminary data show, will be a third less than last year. Secretary of Commerce Sawyer predicts another decline in profits in 1950. Tax penalties imposed by section 102 of the revenue act, as well as other factors, put pressure upon managements to step up dividend payments even while profits shrink.

Smaller and newer businesses have been able to raise equity capital with unusual facility because of the very favorable conditions under which they have operated since the war. We have had a sellers' market in which almost anything could be sold at a profit, because of numerous prevailing shortages. Friends and relatives have been willing to invest money in many new small businesses to supplement Veterans' Administration guaranties, because the risks seemed slight. The number of business concerns in the country has increased by almost a million to a new high record of almost 4,000,000 since 1944. But the end of postwar shortages and the return of a normal buyers' market with keen competition bring the risk element back into business, as should be the case under our system. Newer concerns are bound to find it far more difficult to finance promotion and expansion than in the recent past.

Much can be done, and done now, to alleviate this threatened shortage of equity capital. It is vital, I believe, that timely action be taken now, instead of waiting until the shortage has really become acute and serious damage is done to the presently strong financial structure of American business.

First, let me summarize the steps that investment bankers—the securities business—can take to solve this problem.

There has been a great shift in the distribution of incomes, and therefore of savings, in this country. A much larger proportion of the Nation's savings belongs to the middle and lower income groups of the population. Knowledge about security investment is often lacking among these low income groups. The Survey of Consumer Finances conducted under the auspices of the Board of Governors of the Federal Reserve System showed that most people who would not buy stocks with surplus income are influenced by lack of familarity with stocks, rather than by lack of confidence in them as investments.

It can be said, in fact, that the investors who know about stocks—the high income groups—do not generally have the money to buy them, and those who have the money—the great lower income groups—do not know about stocks. This is a situation that the people in the securities business can do much to correct. An educational and selling job has to be done. It is encouraging to note that the convention of the Investment Bankers Association of America held last week at Hollywood Beach gave a good deal of time and attention to this problem.

One thing that the securities business has done to attract savings of lower income groups into the securities market has been to develop open-end investment companies that provide low-income investors a convenient medium for investing in a diversified group of equities. Net sales of open-end investment company shares in the first 9 months of this year aggregated $200,000,000. This is several times as much money as they raised yearly a few years ago.

Another helpful device is the development of the common trust funds by our trust companies. These provide a more economical and efficient method of investing many small trust funds in diversified equity as well as fixed income securities.

SEC statistics show that the securities business is making real headway also in developing a wider market for direct investment in corporate securities by individual investors. In the first half of this decade, individual investors as a group actually sold corporate securities on balance. In 1946, they bought $600,000,000; in 1947, a billion; and in 1948 1.6 billion dollars. This year, it is probable that more than 2 billion dollars of corporate securities were absorbed on balance by individual investors. This is a very promising trend.

The new chairman of the SEC has promised to undertake what he can to help the investment banking business to do a more effective job of distribution of securities. This is bound to contribute to a solution of the equity capital problem.

I am convinced that the wide ownership of the shares of American business by the rank and file of investors is good for the investors and good for the country.

Many people hesitate to advocate wide ownership of common stocks because of the heavy losses incurred by those who held them in the early thirties. This same reasoning would apply to the ownership of homes, farms, and other property that depreciated severely in the great depression.

The fact of the matter is that common stocks are priced relatively conservatively in relation to earnings and dividends by any historical comparison. The Department of Commerce has calculated that all stocks listed on the New York Stock Exchange sold at 16 times earnings in 1929. They sell at about 10 times earnings, or less, today. Listed common stocks gave an average yield of 3½ percent in 1929; they yield over 6 percent today. By contrast, high-grade bonds yielded more than 5 percent in 1929, and nearer 2½ percent today. And we should not forget that billions of dollars of brokers' loans had been incurred to buy stocks on margin in the twenties, whereas today brokers' loans on stocks are negligible and investors generally are buying for cash, not on margin.

Those who invest directly in common stocks today, generally speaking, are thus getting good value, by any standard of historical comparison.

INSTITUTIONAL INVESTORS

A second point of attack on the problem of the threatened equity capital shortage is the broadening of the market for equity capital among our financial institutions, the custodians of much the larger part of the liquid savings of the Nation. Both because of law and because of tradition, the vast sums collected by American financial institutions—life-insurance companies, banks, savings and loan societies, and the like—are invested entirely or almost entirely in bonds and mortgages. Over the long run, it is not healthy to force this largest segment of the savings of the American people almost exclusively into debt instruments. For one thing, it forces them to buy the securities of companies that choose to issue bonds—often the older industries—so that they invest little in some of our most vigorous and expanding industries, such as the chemical and electrical manufacturing concerns that prefer to issue mainly or exclusively common stocks.

Significant progress has been made in developing techniques of common stock portfolio management to minimize risks of stock investment by institutional investors. The so-called "formula plans" that involve purchase of stocks on a scale-down, and their sale on a scale-up, minimize the timing hazard and avoid dependence upon the highly uncertain art of business forecasting. Diversification minimizes the risk involved in selection of specific issues for institutional portfolios.

I believe it would be wise to authorize all financial institutions to invest a specified moderate percentage of their resources in a portfolio of common stocks. A study made by Scudder, Stevens & Clark has shown that investors that do include equities in their portfolios, like the eleemosynary institutions, have achieved a substantially higher average yield over a period of years, while keeping principal intact, than do the institutions that buy only bonds. It would require, however, changes both in legislation and in the attitude of the managements of many financial institutions to achieve this—changes that an inquiry like yours can do much to bring about.

WHAT MANAGEMENT CAN DO

Business management itself can do much to foster a better market for equity securities. This has been demonstrated by the success of the public utility industry in selling some $750,000,000 of common stocks to raise new capital this year, to supplement its bond financing program. We can study the successful equity financing of the public utilities to great advantage, since it provided clues to what managements in other industries can do to develop a better market for their common stocks. This is particularly true because individual investors in the lower income brackets have been an important group of buyers of the new utility stock offerings.

One thing corporate managements can do is to resist the temptation, admittedly very strong today, to finance the bonds. We have made bond financing very attractive for corporations in three ways. Bond interest is a deduction from taxable income for corporations, whereas dividends must be paid from taxable income. A corporation that sells 3-percent bonds must earn 3 percent on such capital to meet the interest. A corporation that sells common stock paying 6 percent—and most corporations must promise more than that to find a market for their equities—would have to earn 10 percent so that, after a 38-percent corporate income tax, there would be 6 percent left for dividends.

Furthermore, the easy-money policy of the Treasury and the Federal Reserve System makes it easier for corporations, as well as the Federal Government, to borrow at extremely low interest rates. Low interest rates, as well as tax advantages, make bond financing exceptionally tempting.

Yet I believe it is the duty of corporate managements to finance at higher cost with equities so far as feasible. Bond financing, for the average industrial company, should be used for emergencies. The trouble with bond financing is not so much that interest is fixed—low money rates and tax advantages take care of that—as that sooner or later the principal comes due. Inability to meet principal is the usual cause of financial embarrassment. And bond financing is like a habit-forming drug—it is easy and pleasant at first, but the more a corporation resorts to it, the more necessary it becomes to borrow more, until stock financing becomes impractical and the business is headed for the financial rocks,

The Investors' League has a particular interest in seeing corporate managements resort to stock financing to a greater extent, because this will make both the bonds and the stock that our members hold sounder and more valuable investments.

Corporate managements can promote a wider market for equities by—

1. Paying out a larger proportion of total earnings over a period of time as dividends, where equity capital is to come mainly from selling stocks and not from withheld profits. The liberal dividend policy of the public utilities has done much to broaden the market for their equities.

2. Returning to regular dividend policies. Investors in equities, as distinct from the in-and-out trader, like regular dividends. The most popular single equity investment in America, the capital stock of the American Telephone & Telegraph Co., has paid 9 percent each year in the past 30 years. And more than 800,000 investors in this country are satisfied and contended holders of the A. T. & T. stock. Many of these holders bought the stock during the boom of the twenties and they have held it through the greatest of all depressions. The price has fluctuated, it is true, but they have received the same $9 dividend in each year during this difficult period.

We know hat the telephone business is more stable than most business. But corporations generally can do a great deal to stabilize their dividend payments by building up reserves in good times to sustain dividends in bad, by maintaining a strong liquid position, and by developng more stable sources of income through diversification of their activities where they are now in a highly cyclical field.

Maintenance of regular dividends was a major policy objective of our stronger enterprises until the twenties. Then the numerous split-ups of the twenties, the depression of the thirties and the ill-advised undistributed-profits tax of 1936–39 all conspired to make dividend disbursements more erratic. Section 102 of the Revenue Act, imposing a punitive surtax on "unreasonable" accumulations of surplus, has the same effect to some extent.

If we want a wide market for corporate equities, every assistanec and encouragement should be given corporate managements to return to a regular dividend policy, so that the investors in their shares will have reasonable assurance that dividend payments will be maintained in the future.

WHAT GOVERNMENT CAN DO

Since Government has assumed so much more important a role in our economy than in the past, it can do much, along with the investment banking profession, institutional investors and corporate managements, to promote the development of a vigorous, adequate market for equity securities.

I am fully aware that the budget is unbalanced today, and that other witnesses before this committee have said much about the desirability of economy and the balanced budget. There are a few changes in tax law and administration that can be made, however, that would do a great deal to develop a healthy market for equity securities and would cost the Treasury relatively little. Furthermore, this cost would be covered several times over by two items of economy that are either assured or readily attainable. I refer specifically to the 1.5 billion dollars reduction in defense expenditures disclosed by Secretary of Defense Johnson and by the 1.3 billion dollar reduction in Federal expenditures that could be achieved forthwith through liberalization of the regulations under which insured home mortgage loans are made to veterans, so that these mortgages would be purchased by financial institutions rather than by the Federal National Mortgage Association with Government money. In a period when financial institutions are so eager to buy mortgages, including insured mortgages on veterans' housing, I cannot for the life of me see how one can justify the revised budget item of 1.3 billion dolars for the current fiscal year to cover purchases of home mortgages by Fannie May.

The specific proposals I would make for Government action to foster equity investment are:

1. Tax relief for smaller businesses, which find it most difficut to raise equity capital in the open market.

2. Reform of section 102 of the Revenue Act, to avoid interference with the flow of new equity capital to enterprise.

3. A limited tax credit for dividend income up to a moderate maximum to encourage investment in stocks by individuals by an initial modest abatement of the present double taxaton of corporate income distributed as dividends. A more thorough correction of double taxation must await the time when the budgetary situation is stronger and a surplus is available for debt reduction.

First, let us consider how more venture capital can be procured for smaller businesses. A study of business history in the United States make clear that many of our great industrial enterprises, in following the acorn-to-oak pattern of growth, have depended largely on retained earnings as a major source of equity capital. If we still believe in the system of free enterprise which makes it possible for a young enterpriser to start on a shoestring, produce valuable goods and services for mankind, become a millionaire and also a benefactor to the world, undue obstacles must not be placed along the road to prevent acquisition of equity capital for small concerns. Under prevailing conditions a Ford Motor Co. or a du Pont Corp. cannot emerge out of a small business because, while yet small but growing fast, it is compelled to turn over so large a proportion of its earnings in taxes and/or dividends that there is nothing left to make expansion possible. There are several things tax-wise that can be done to remedy this situation. In the first place, corporate income tax rates should be changed so as to reduce the tax on the first $50,000 of corporate income to, say, 10 percent, the next $100,000 of corporate income to 20 percent, and the next $50,000 of corporate income to 25 percent. The present 38 percent rate woud then apply to corporate income in excess of $200,000, instead of applying to corporate income in excess of $50,000. In the second place, section 102 of the Revenue Act should be amended to provide that the surtax may not be imposed upon any business whose retained earnings are less than $200,000. These two changes in the tax law would make a larger proportion of the income of smaller businesses available for financing expansion and for new ventures, and so provide equity capital to smaller concerns that can rarely sell stock to public investors.

As Senator O'Mahoney has properly pointed out, those who propose a reduction in Government revenues should also make specific suggestions as to how such revenue reductions can be offset. I estimate (subject to correction) that reduction in the tax rates on smaller corporations such as I have outlined would involve a revenue loss of about $300,000,000. No material revenue loss would develop in making section 102 inapplicable to small businesses, since the assessment for which this section provides has seldom been imposed upon small concern in the past. This revenue loss of $300,000,000 would be far more than offset by the two items of expenditure reduction mentioned.

Next, let us consider how Government can facilitate the flow of venture capital into larger businesses. American business history has demonstrated that retained earnings devoted to the acquisition of productive assets and stabilization of future dividend payments are beneficial to the entire economy. If section 102 of the Revenue Act were liberalized, more venture capital could be assured for larger businesses, because of the fear of an assessment makes this section far more effective than any revenue collected under it would indicate. I propose two amendments to that section. First, an amendment to provide that the surtax imposed thereunder would not apply to a corporation that invests its retained earnings in fixed tangible assets, whether in its own or in another enterprise. Second, an amendment to provide that the surtax imposed thereunder would not apply to sums set aside as a reserve for the exclusive purpose of paying dividends upon stock in later years, at the same rates as those prevailing at the time that the reserve was created.

The first amendment would overcome the uncertainty and would relieve the undue pressure to pay out dividends that are produced by section 102. At the present time many managements fear that section 102 will be applied to them if they do not pay out the bulk of their earnings as dividends, because the Bureau of Internal Revenue may hold that earnings invested in assets which are not directly connected with the current business are retained "beyond the reasonable needs of the business." Of course, this proposal would not reduce Treasury income materially because of the limited enforcement of section 102 to date.

My second proposal, looking to the maintenance of regular dividends rather than to larger payments in any one year, is of particular importance for the reason that investors in common stocks show an increasing interest in current dividend yield rather than in capital gains. The Survey of Consumer Finances carried out under the auspices of the Board of Governors of the Federal Reserve System, as described in the October issue of the Federal Reserve Bulletin, throws much needed light upon the attitude of people toward investment in corporate stocks. Of those who favor the investment of savings in stocks, the majority ascribe their preference to the higher yield provided by such securities.

This attitude is supported by the striking ability of the public-utility industry to sell some $750,000,000 of stock to investors this year at yields averaging at least 6 percent. When commercial banks generally pay 1 percent on deposits, mutual savings banks 2 percent, and savings and loan associations 2½ to 3 percent, common stocks which yield 6 percent are in a relatively very favorable position. Plainly these facts give ample proof of the growth of yield consciousness among the rank and file of small investors and savers in this country. The establishment of a dividend reserve out of earnings would do much to make the shares of industrial corporations, whose earnings are subject to much more fluctuation than those of public utilities, more attractive to the rank and file of smaller investors, because a dividend reserve would insure the maintenance of dividends to a greater extent when earnings are less favorable. At the present time the establishment of such dividend reserves consisting of cash of Government securities invites the application of the surtax under section 102.

A third proposal which I would like to make to ease the shortage of venture capital for large and established corporations is to provide in the tax law a tax credit to the stockholder for dividend income, equal initially to 10 percent of the dividend income not in excess of $1,000 for any taxpayer. Admittedly, this is only a beginning in the direction of correcting the double taxation of corporate income which is distributed as dividends as imposed by our present tax laws. If we are in earnest about reviving a market for equity capital in this country, however, it is high time that a start were made in this direction. This proposal involves a loss of Treasury revenues which, according to unofficial estimates, would be about $300,000,000 per annum. But here again the reduction is only a fraction of the total savings from lower defense expenditures and from the liberalization of veterans' home-mortgage terms which, as outlined before, would lead to a shift of the FNMA portfolio to private institutional investors.

Positive, effective, and early action is required to encourage the flow of venture capital into small and large businesses, if additional jobs are to be provided to absorb the 700,000 persons who, according to the Department of Labor, are added annually to the Nation's labor force. As investors, we feel that only a cooperate effort on the part of investment bankers, institutional investors, business managements, and the Government will suffice to solve this problem in time. We feel your committee, in its report, can provide a rallying point about which such a cooperative effort can be carried out to successful fruition, for the benefit of the entire Nation.

Mr. SCOLL. Also, we will have shortly a statement from the American Federation of Labor. They were unable to appear this morning, and their statement also will be distributed to members of the committee and made a part of the record.

(The statement referred to is as follows:)

STATEMENT OF WILLIAM GREEN, PRESIDENT, AMERICAN FEDERATION OF LABOR

The demand for goods and services of all types is made up of purchases of consumers' goods to meet everyday needs and wants, and the investment of savings in capital goods. The creation of a supply to meet this demand provides employment and wages for the labor force, and profits for business enterprises. A decline in either consumption or investment will lead to a drop in employment, wages, and profits. If this decline goes far enough, a prolonged depression may ensue.

It may fairly be said that consumption is the more basic of these two broad factors of demand, since all production has consumption as its long-run aim. The level of consumption, determined by the amount and distribution of purchasing power, will ultimately decide whether plants and machinery can be put to profitable use, or whether stocks of goods in the hands of dealers can be sold at a profit. To recognize this basic proposition is not to deny the importance of the role of investment in our national economy. It is merely to emphasize, before going more deeply into the question of private investment, that investment is not an end in itself but a means to an end, and that the expansion of production serves no purpose unless the purchasing power is available to take the products off the market.

Every increase in money incomes must be met by like increase in the supply of goods, if the additional money income is to have any real value in terms of goods. Private investment is essential to our ability to produce more goods at lower cost. Private investment also provides a productive outlet for savings left after consumption needs and wants are met, and enables these savings to add to the total volume of demand and to thereby create new employment opportunities.

As incomes rise, the share which must be used to buy food, clothing, and other essentials does not rise to the same extent, so that savings tend to increase. These savings must be invested if the current level of employment is to be maintained. If savings are allowed to lie idle, and used neither for consumption nor investment, the total volume of expenditures will drop. Since every person's income is made up of the expenditures of others, this will lead to a drop in production, employment, and incomes. As long as these savings are invested, production and employment will be maintained.

The record shows that the level of investment rises and falls much farther and faster than the consumption share of incomes. A large part of consumption expenses are urgent and immediate and cannot be postponed, while practically all investment spending can be readily put off. When enough people decide to hold their savings in cash form rather than to tie them up in investments, a drop in employment and production follows the drop in investment.

All thoughtful persons will agree that the survival of our free-enterprise system depends to a great extent upon our ability to prevent or to counteract severe drops in the level of employment. One of the basic economic problems of today, therefore, is to work out appropriate and generally acceptable means of increasing the stability of the flow of expenditures, of which private investment is so important a part.

In any consideration of this question, the term "private investment" must be given a broad definition. It is not limited to spending on plants, and inventories. There are may items which depend more directly for their markets upon the great mass of consumers, but which have many of the same economic characteristics. They involve long-term financial commitments. A large part of the demand can be postponed, and their purchase represents a form and outlet of savings. In this group are such items as housing, autos, etc. A large stable market for these items would do much to mitigate sharp rises and falls in employment and production, and this should be considered in connection with the broad problem of stabilizing private investment.

One of the best approaches to the problem of softening the effects of sharp drops in private investment is to be found in programs aimed at improving the relative economic status of lower-income groups. As stated by Assistant Secretary of Commerce Blaisdell in his recent testimony before the Subcommittee on Low-Income Families:

"As to income redistribution, I am inclined to believe that a moderate amount of it, applied in a judicious manner, will benefit the general health of our economic system. The probable consequences of such a redistribution would be to raise total consumption in relation to income. Provided that investment is not affected this would make for the long-run operation of the economy at a higher percentage of productive capacity. Moreover, there are reasons to believe that an economy in which the proportion of consumption to investment was increased would be less subject to cyclical fluctuation than an economy in which the relative share of investment is higher. Finally, the task of preventing, correcting, or offsetting short falls and excessive fluctuations in investment expenditures would be made more manageable."

The American Federation of Labor has presented its proposals as to specific programs, whereby the incomes of these low-income groups might be raised, in its testimony before the special subcommittee set up to examine that question. It will suffice to merely emphasize here that these questions are not separate and distinct from one another, but are closely related.

The American labor movement, in the pursuit of its economic aims, is an instrumental factor in the building of a broad and stable foundation for the economic development of this country. It has sought to secure for its members, and workers generally, a full share in the economic and social progress of the Nation. In so doing, it has helped to bring about a wider distribution of the purchasing power required to sustain our industrial output. This expansion of the mass market has led to the expansion of opportunities for profitable private investment.

Furthermore, as wage levels have moved upward under collective bargaining, many workers have been able to save something out of their wages for the first time, and to provide against old age and misfortune. The creation of retirement funds has diverted a portion of workers' income directly into savings. As wage levels rise, these savings and reserves will likewise continue to grow.

This will bring about a broader mass participation in the provision of funds available for capital formation, through many small savings accounts, insurance policies, retirement funds, etc. Sound investment outlets will be needed for these funds. It seems clear that over the long run the problem of private investment will not be one of a shortage of funds from which investments might be made, but rather a matter of assuring that profitable new investment opportunities will be present in sufficient quantity to provide a steady demand for such funds.

It has been pointed out that the wage gains of labor help to maintain and expand purchasing power and consumer demand; a word should also be said about the effect of rising wage levels upon the demand for investment goods. While the wage demands of labor may be a thorn in the side of cost-conscious employers, it can nevertheless be shown that steady upward wage pressure provides a powerful stimulus to industrial and technical progress. With low and static wage levels, and a labor force that is without real bargaining power, industry tends to rest on its laurels, and to stagnate. Management is under no pressure to make cost-reducing innovations, to install more efficient machinery, and improve the productive processes. As long as labor remains cheap and weak in bargaining strength, it will not pay to install expensive machinery and equipment, and competitive pressure on profits, from other producers, may be shifted to labor by cutting wages still further.

A classic example of this stagnating effect of cheap and defenseless labor may be found in parts of the Orient, where the cost of labor is so low that there is little incentive on the part of employers to seek means of increasing efficiency and productivity, or to invest in new and improved machinery.

When faced with rising wage rates, management is compelled to exercise that ingenuity for which it is so justly famed and so well paid, in order to keep total costs down to a competitive level, where effective price competition exists. It becomes worth while to carry out expensive research, to install new equipment, and to replace outmoded and inefficient plants and machinery. In short, it becomes worth while to continually make investments, and to search for ways and means of increasing productivity.

Improvements in productivity do not take place in a vacuum; rising wage levels are both a cause and an effect. Any attempt to keep wage levels static, as a matter of policy, until after an increase in productivity has taken place, as some have proposed, would defeat its own purpose for one of the forces behind our gains in productivity would be removed. Wage increases provide both an incentive for investment and greater output per man, and the broadened market necessary to absorb the added output.

Some of the testimony before this subcommittee has made the mistake of assuming that what might be sound policy for an individual firm under a given set of circumstances would also serve as an appropriate guide to governmental policy in meeting the problem of stabilizing private investment. The point has been ignored that actions taken by individuals and firms, which may be perfectly rational from their point of view, may aggravate the very condition that governmental policy should be designed to correct.

As an example, it may serve an individual's own self-interest under certain circumstances to play safe and refrain from investing his savings, holding them instead in cash form. From the point of view of total demand, however, it is clear that such action would tend to conflict with the general aim of stabilizing private investment. Thus there have been frequent instances in the past where the desire for cash, on the part of individuals and firms, such as banks has led to the withdrawal of funds from investment and the liquidation of assets, and thereby started a general decline in demand and employment.

A point that should be noted here is the fact that the adverse consequences of these actions do not strike the individual responsible for them, except perhaps by chance and the law of averages. Through the interplay of economic forces, the cumulative effects of such decisions may lead to hardship and the loss of jobs on the part of persons far removed from the actual scene of the decision, who had no part, or freedom of choice, in the making of that decision.

If we are to have a steady high level of employment, these periodic adverse effects of actions taken by individuals and firms in the pursuit of legitimate self-interest must be reconciled with this general policy. Here the Government is able to play a constructive role. This does not mean that the individual should be obliged to subordinate the direction of his private investment decisions to broad social aims as embodied in Government dictates. It does mean that the Government should be ready to aid in filling the gaps where the level of private investment is insufficient to maintain employment.

The instruments available to the Government for this purpose, which in no way infringe upon individual liberties or freedom of choice, are many and varied. Among them are its monetary, credit, and fiscal powers. The views of the American Federation of Labor with regard to appropriate policy in this field have been submitted to the subcommittee set up to examine that question.

The Government should be prepared to supplement private investment by direct capital outlays on useful public works, and development programs which cannot be adequately undertaken by private industry, in coordination with State and local community projects. Included in this general area are such programs as urban redevelopment and slum clearance, highway construction, regional development programs such as TVA, educational and public-health facilities, etc.

These direct outlays should be channeled into fields, such as the above, where they do not directly compete with private investment, to assure that they will, to as great an extent as possible, supplement rather than cancel out private investment that would otherwise have taken place. Public investment of this sort should, in fact, stimulate additional private investment, by making possible efficiency and economy of operation, through the provision, for instance, of cheap and ample electric power, and more economical transportation.

Legislation more liberal than that in effect at present should be adopted, to make possible coordinated long-range public-works planning and the maintenance of an adequate shelf of these projects, so that action may be taken without delay when the situation demands it.

Another vital area in which the Government has a distinct contribution to make is in the stabilization and expansion of the construction of residential housing. The position of the American Federation of Labor with regard to specific legislation needed in the housing field has been clearly stated before various congressional committees in the past and needs no detailed repetition here.

Various proposals have been put forward whereby the Government would be enabled to give credit assistance to private persons and firms. Many of these proposals have special aims other than the broader one of filling in the gaps in over-all private investment, such as aid to small business, the maintenance of freedom of entry into fields where competition might otherwise be stifled; the encouragement of private investment in special areas, etc. Some would place these credit powers under a single agency; others would place them under separate agencies. In some proposals, loan guaranties are favored; in others, direct loans are favored. This is a broad and complex field, about which it is difficult, and perhaps unwise, to make blanket recommendations, at least without a fairly elaborate structure of qualifying remarks. Questions as to the need for Government credit in a given situation, the proper agency for its administration, and the relative merits of direct loans and guaranties, can be dealt with more adequately in connection with specific legislative proposals, in the light of the major purpose sought to be accomplished, and the surrounding factors.

It should be remarked, however, that under any program whereby the Government extends financial aid to private firms, some definite assurances should be given that firms which benefit from such public aid will maintain decent labor standards, commensurate with those prevailing in the industry in which it is engaged. Public aid to firms which maintain substandard wages and working conditions, and are thereby enabled to undermine the competitive position of other firms which do maintain adequate labor standards, is not only a miscarriage of justice, but also undermines purchasing power and total demand. Competitive advantages should derive, not from lower labor standards, but from the ability to produce efficiently and at lower cost, while maintaining proper standards.

If such a rule is observed, then the availability of credit assistance from the Government might very well prove of value in stabilizing investment, and in promoting constructive competition and technical progress. It might aid in assuring freedom of entry—which is of basic importance in maintaining competition—into industries where access to capital might otherwise be blocked by the interlocking interests of banking and investment houses and dominant firms already in the field. If new firms, with new ideas and processes, are unable to get started in many fields, opportunities for new investment and technical progress may be lost. Established companies, over the course of their existence, acquire a large financial stake in the continued profitability of their past investments, and may tend to resist the introduction of innovations which may render their older, higher-cost facilities obsolete. The problem of maintaining freedom of entry is therefore an aspect of the broad problem of stabilizing new investment.

This points also to another area in which the Government can perform a constructive service. That is, in the field of research. At present, only large and established firms can afford to maintain elaborate research facilities. This gives such firms the inside track on new developments, on which they may obtain exclusive patent rights. These may or may not be put into prompt use. A Government-sponsored research program for smaller businesses, or the sponsorship of joint cooperative research facilities by a number of different firms, could aid in overcoming this handicap, and bring about the wider diffusion of technical knowledge, particularly if new inventions and processes developed with Government aid are made freely available to all comers on equal terms. Particular emphasis should be placed upon the development of capital-saving devices and techniques, whereby the same or a greater volume of production might be achieved with lighter, smaller, and less-expensive capital units.

The greatest contribution that can be made to the cause of small business is the maintenance of high-level employment and purchasing power. Small businesses are most numerous in the service and trade industries which depend most directly for survival upon the level of consumer incomes and expenditures. While there is a real problem of enabling small business to obtain capital more readily, it should be noted that no matter how much capital is poured into a business, it will not survive unless it can find customers for its goods and services. The problem of a lack of ready capital is likely to be much less acute for any business, large or small, which is able to attract steady patronage than for one that is not.

Under any conditions and with the best of maangement, however, there will be a number of sound small enterprises facing short-term financial difficulties, or seeking to expand, which are unnecessarily handicapped by lack of access to the capital market. Such firms may also find themselves in a vulnerable position in the face of cutthroat competitive practices by larger companies with more ample internal resources. The wider development of community capital financing problems might provide some aid to small business. The need for Government credit assistance to supplement such aid is certainly worth further consideration.

There appears to be little merit in the proposal that the various State laws regulating investments by insurance companies should be liberalized to permit insurance companies to buy more corporate equity shares. It is doubtful whether a soundly managed company would take advantage of such an opportunity if it were open to it, since security of capital and regularity of income are basic considerations in the investment of funds in back of insurance policies, by their very nature.

As to the controversy with regards to the state of the stock market and the alleged scarcity of equity capital, there seems to be little if any justification for special measures, such as tax "incentives," designed to stimulate the market for corporate stock issues. The market has responded favorably to recent increases in the proportion of profits paid out in dividends, and does not appear to be unduly depressed at the present time. Even were this not the case, such measures would represent only a partial approach, at best. The state of the stock market at any given time is governed by variety of different influences, of which the tax situation is only one. The international situation, fear of another depression, and other more or less intangible factors also enter the picture. Probably the greatest contribution that the Government could make toward stimulating a healthy demand for corporate shares, and the willingness to take risks, would be to give assurance that it is prepared to take whatever steps might be necessary to the promotion of a sustained high level of employment and production.

The remarks and observations contained in this statement by no means pretend to thoroughness, and many important aspects of the broad problem of assuring a stable level of private investment have not been discussed at all. Further study is needed on many of these points. The American Federation of Labor is very much aware of the significance of this problem in relation to the future welfare of workers and of the public generally, and will be watching further developments with the greatest interest.

The CHAIRMAN. This afternoon the witness will be Mr. David Van Alstyne of Noel & Co., New York. These are investment underwriters, I understand, who have specialized in underwriting small business.

The committee will stand in recess until 2 o'clock.

(Whereupon, at 12:10 p. m., the committee recessed, to reconvene at 2 p. m. of the same day.)

AFTERNOON SESSION

The CHAIRMAN. The committee will come to order.

Mr. Van Alstyne, will you come forward, please?

We appreciate very much your appearance here today, and we are looking forward to the contribution we know you will make. You may proceed, if you will, sir.

STATEMENT OF DAVID VAN ALSTYNE, JR., ACCOMPANIED BY BRUCE TUTTLE, VAN ALSTYNE, NOEL & CO., NEW YORK CITY

Mr. VAN ALSTYNE. Thank you, Senator. I appreciate the opportunity of being given a chance to express my views. In accordance with the request of Mr. Scoll, this original memorandum has been kept to a reading time of about 14 minutes.

My name is David Van Alstyne, Jr., and I am senior partner of the investment banking firm of Van Alstyne, Noel & Co., 52 Wall Street.

EQUITY CAPITAL PROBLEMS

This subject is so enormous it would be impossible in the time allotted to me to cover its several aspects in detail. Therefore the memorandum which I am presenting to this committee is more in the nature of a staccato outline. On the other hand, I hope the answers to the various problems raised will not be obscure.

Our American economic system can only flourish in a healthy political climate where there is cooperation and confidence on the part of both Government and business. Excessive red tape, excessive taxation, excessive legal attack, constant changing of laws, all tend to stifle business and the incentive of the individual to risk his capital in the purchase of equity investments.

I. *The importance of equity capital*

The steady and increasing flow of additional capital is the lifeblood of our economic system. Once this truism is accepted, the problem is to determine what is the best method by which this steady flow of capital may be continued. There are three principal methods by which new capital can be obtained: debt financing, retention of earnings, and stock financing.

(*a*) Debt financing: Unfortunately, with few exceptions, for the past 15 or 20 years a large percentage of new capital has been supplied through debt financing. There are many dangers inherent in this method: Debt financing is not sufficiently flexible; it tends to endanger the safety of the borrowing corporation in times of depression or low earnings.

The constant requirement of a corporation to meet the carrying charges on its debt frequently causes it to adopt corporate policies which are dertimental to the best interests not only of the corporation but of the national economy.

Excessive debt requirements tend to bring on a larger number of corporate failures in times of economic stress, which accent deflation just at the very time when the national economy should be receiving strong support.

(*b*) Retained earnings have probably been the chief source of new capital in the postwar period. However, this is a very uncertain source upon which to rely. Even if the national economy did not have "hills and valleys," most industrial corporations tend to have fluctuating earnings. In times of low earnings, a corporation might need to modernize its equipment, establish new products or have other substantial uses for new capital, just at a time when the flow of retained earnings might cease. In addition, it is becoming more hazardous to rely upon retained earnings as a source of capital, because of the pronounced tendency of recent date on the part of the Treasury Department to enforce more strictly the provisions of section 102 of the Internal Revenue Code. In the case of new enterprises, retained earnings as a source of new capital are nonexistent.

(*c*) Common stock financing is the best way to bring new capital into our economic system: (1) It widens the stake in this system; (2) it is tremenedously important that as many citizens as possible have a stock interest in the industrial life of our country; (3) common stock financing is by far the most flexible method.

In times of depression it is less hazardous, because there are no fixed charges or dividend payments that must be met. It is absolutely inherent in our corporate system that there be a strong common stock base for every well financed company. We should never forget that the ownership of common stock represents the interest of the individual citizen in land, buildings, and equipment (the tools of production), which have given our country the highest standard of living in the world. Only if there is an increased flow of new capital through the sale of common stock will there be provided expanded production facilities to create increased employment and prosperity, to combat deflation and to raise this standard of living.

II. Why has there not been more common stock financing in recent years?

New issues of common stocks can only be sold if they compare favorably with outstanding issues. Such comparisons must include, among other factors, yield on investment, earnings, assets, type of industry.

Below is given a table of nationally known common stocks for comparative purposes.

Current per-share data on listed stocks as at Dec. 8, 1949

Group and security	1949 earnings per share, fiscal year (estimated)	Market Dec. 8, 1949	Price earnings ratio	Dividends paid 1949	Yield
Aircraft:					*Percent*
Douglas Aircraft Co., Inc	$12.00	67	5.5	$9.25	13.8
North American Aviation, Inc	2.00	11⅛	5.5	1.25	11.2
Auto parts:					
Budd Co	3.75	11⅞	3.1	.70	5.9
Murray Corp. of America	[1] 6.95	14⅞	2.1	1.60	10.7
Young (L. A.) Spring & Wire Corp	[1] 9.05	27½	3.0	3.00	10.9
Automobiles:					
Hudson Motor Car Co	5.25	13⅞	2.6	1.70	12.2
Nash-Kelvinator Corp	5.75	17⅛	2.9	2.15	12.5
Studebaker Corp	8.00	24¼	3.0	2.50	10.3
Baking and milling:					
Continental Baking Co	3.75	16¾	4.4	1.15	6.8
Ward Baking Co	3.50	17½	5.0	2.00	11.4
Building: Pennsylvania Dixie Cement Co	4.75	22¼	4.6	1.75	7.8
Chemicals:					
Pittsburgh Coke & Chemical Co	4.00	12¼	3.0	.95	7.7
Virginia Carolina Chemical Corp	[1] 4.88	7½	1.5	0	0
Coal:					
Pittsburgh Consolidation Coal Co	7.00	29¾	4.2	3.00	10.1
United Electric Coal Cos	[1] 4.61	17	3.6	1.50	8.8
Distilling:					
Brown-Foreman Distillers Corp	[1] 5.69	11⅞	2.0	.80	6.7
Distillers Corp. Seagram's	[1] 3.96	17½	4.4	1.05	6.0
Machinery:					
Minneapolis-Moline Co	6.50	13⅜	2.0	.90	6.7
Oliver Corp	7.50	25¾	3.4	3.00	11.6
Worthington Pump & Machinery Corp	5.00	15⅝	3.1	1.00	6.4
Metal fabricating: Revere Copper & Brass, Inc	3.00	14¾	4.9	1.50	10.1
Metals: Miami Copper Co	2.90	13⅜	4.6	1.75	13.1
Tires: General Tire & Rubber Co	5.00	19¼	3.8	2.00	10.4

[1] Actual.

You will note from the above that the yield on a number of the common stocks of nationally known companies is very high; that it would be exceedingly costly for the management of these companies to sell additional common stock on which it would have to pay up to as high as 13 percent in order to obtain its money. In addition, these stocks are selling at a very low price to earnings ratio, therefore, the sale of additional common stock would represent a tremendous dilution for the present stockholders. It must be remembered that stock financing of new enterprises must be sold in competition with this price structure. Consequently, when management is faced with the problem of acquiring funds, whether new or additional, for any one of a number of corporate purposes, it tries to avoid selling common stock on such onerous terms. Accordingly, retained earnings being insufficient or not available, debt financing offers a strong appeal. This is further enhanced (a) because of the tremendous surplus of funds in the hands of the large life insurance companies, (b) because of Government control of the bond market which has created low interest rates, (c) because interest can be deducted before determining earnings upon which income taxes must be paid but no such deduction is available for dividends paid which are again subject to taxation in the hands of stockholders. For these reasons and others, directors are forced to take the easiest route and obtain their new funds in the form of debt financing, even if it means an increase of the debt structure on their corporation.

The obvious conclusion to this is there cannot be any substantial amount of new common-stock financing until the present prices of stocks, in relation to price-earnings ratio, and return on investment improve very materially. In this connection it must be observed that it is difficult, if not impossible, for anyone to pick a year in which the economy might be described as normal. The index of price-earnings ratios at which new issues of common stocks can be floated readily is probably best found in the figures that obtained in the year 1936. At that time the common stocks of middle-sized to smaller industrial corporations sold on approximately an 8-to-10-times earnings basis. Somewhat larger corporations in special fields of endeavor sold above 10 times earnings. Some of the very large nationally known corporate stocks sold above 20 times earnings. In such an economy the advantages to management in raising new capital through the sale of common stock are too obvious to require comment.

III. What conditions are necessary to cause common stocks to sell at prices which would stimulate new equity financing?

Under the present laws, taxes absorb such a high percentage of individual income that a substantial amount of funds which were formerly available for investment in equities are now siphoned off by the Government. A large percentage of equity funds were formerly obtained from people who were able to save substantial sums of money after living expenses and taxes. This is difficult to accomplish today.

Moreover, with respect to new financing, there is very little inducement for a man with capital to risk his money. If he puts his money into a proposition which is at all hazardous he stands the risk of losing it all; and, on the other hand, if the venture succeeds, a not inconsiderable percentage of his profits are taken by the Government. Under these circumstances capital funds prefer to lie dormant or to be invested solely on an income basis regardless of how low the return, rather than with the idea of increasing the capital funds.

In this respect the capital-gains tax has had a profound effect in keeping funds out of the stock market. Again we have the case, if the investor purchases a stock and it goes down, he sustains all of the loss, and if the stock goes up a not inconsiderable percentage of the profit is taken by the Government. There is no doubt that the capital-gains tax is a great deterrent to the investor of funds in the common-stock market, whether in outstanding or new issues.

Why the Government keeps this tax is hard to understand. I have been reliably informed that the amount of money collected from the capital-gains tax for the last 11 years averaged only $155,000,000 per annum. This is obviously a very expensive tax for the Government. I am convinced that the elimination of any tax on capital gains would produce a vastly greater sum from other sources than would be taken away. This would be a very realistic approach to the solution of the problem.

As heretofore mentioned, a corporation pays no taxes on income used to meet interest charges. On the other hand, the dividend return on common-stock investment—which I repeat is the lifeblood of our whole economic system—is subject to double taxation. This tax is first assessed on the earnings of the corporation and secondly when the dividend comes into the hands of the individual stockholder. Once more we see that the Government lays emphasis on debt financing and deters equity financing.

IV. Additional problems in the case of small business

It is my understanding that the committee is interested in problems surrounding the financing of small business. I have asked many times before, "What is the definition of 'small business'?" I have been told that different departments of the Government define it in different ways—some by the number of people employed, some by the net worth of the corporation, some by the gross volume of business done.

I prefer to define "small business" in relation to the percentage of volume a particular company does to the total amount of business transacted in that specific industry. In other words, if the total volume of business done in a specific industry in the United States only amounts to $1,000,000, any company transacting $500,000 in that industry in a year is "big business" in that field. On the other hand, possibly in the steel industry, a company doing $10,000,000 of business is in many ways "small business."

One of the most tragic aspects of the problems confronting small business is again attributable to our tax laws. Many of our finest corporations, which have contributed so much to our economic life, would have been unable to attain their present success had their principal years of growth been burdened by the existing tax laws.

It is exceedingly difficult, if not impossible, today, for the average corporation to keep up with competition, by growing from within itself. The larger corporations, for the most part, are well financed. But the smaller corporations, on the other hand, have to use every bit of strength and ingenuity to compete with the larger ones. Even though they are constantly in need of additional facilities with which to wage the warfare of competition succesfully, they must, nevertheless, pay out substantial sums of money to the Government in the form of taxes. The net result is that the tax laws tend to keep the "small man" small.

Another serious problem of the small-business man stems from the inheritance-tax laws which again operate in a similar manner. Many a small to middle-sized fine old family concern has been built up through the efforts of one man or one man and his sons. The founder with his family owns all or substantially all of the stock of his corporation. When he reaches a certain age he is invariably advised by his attorney that he should sell a considerable percentage of his stock to the public—which at present price levels is exceedingly difficult or may involve a sacrifice—or sell his company out to a large competitor, so that his affairs will be in order to meet estate- and inheritance-tax drains. Again we see how the tax laws of our country tend to force out the small family owned business.

V. Conclusion

From the foregoing I believe it has been demonstrated that the steady stream of equity capital which formerly flowed to the benefit of our economy has dried up to such extent as to become alarming. Nor is this drought temporary in the sense that it can probably be revived by itself. Unless some of the dams to free flowage of equity money are lowered or removed, it may well be that only mature existing companies with adequate retained earnings will have ready access to equity capital for future expansion. Independent and small businesses will be forced more and more to resort to debt financing.

The lack of ability of small business to avail itself of equity financing has been shown either to jeopardize its solvency or to drive it into big business. But under present conditions, even big business finds equity financing too costly. Accordingly, the Congress should take such means as are within its power not only to insure the continuance of our present vigorous American economy but also to expand our productivity which is essential to enable the Nation to meet the tremendous problems confronting it.

The CHAIRMAN. Mr. Van Alstyne, as I listened to your paper, it seemed to me that you are laying principal emphasis upon equity financing of large corporations. That is to say, corporations which are directed by management rather than by owners, and that you are thinking in terms of the stocks which are traded in on the exchanges rather than the companies which are growing up in various parts of the country for which opportunities exist and which are unable to grow because they do not have access either to debt capital or to equity capital.

They do not have access to debt capital because the savings of the country are institutionalized, and the large institutions on the record find it much easier and more profitable, I think, too, to take the larger issues. Equity financing in this type of business is difficult because so many owners do not want to share that ownership, but still they cannot get the long-term loans which are essential.

Have I correctly analyzed your point of view?

Mr. VAN ALSTYNE. I think you did, Senator, up to a point, if I may interpolate in this way. I did not mean to confine my thinking solely to large nationally known and listed companies. So far as your small family concerns are concerned, if an entirely family owned concern does not want to sell stock to the public, there is nothing that you and I or anybody else can do about it. They do not want to do it, and that is all there is to it.

But let us take the type of property we are talking about and assume they would like to sell stock to the public to get increased capital to help them expand. They think if they got equity money on a reasonable basis they could put that profitably to work so that the whole enterprise and the stock which they retained would become more profitable. That is what I refer to here.

It boils down to this: It does not make a bit of difference how much anybody wants to sell stock. Every stock that is sold to the public must be measured in terms of value as against all the other stocks outstanding.

The CHAIRMAN. Oh, yes; you are quite right. But let us think now in terms of the sort of stock which is the commodity of the investment broker. Now, isn't that for the most part the stock of companies the business of which is managed by the managers and not by the owners?

Mr. VAN ALSTYNE. Excuse me, sir. Do you want me to give you a list?

The CHAIRMAN. Certainly. That is what I am trying to find out.

Mr. VAN ALSTYNE. My lawyer here, Mr. Tuttle, brought this list along. I did not have enough brains to do so.

The CHAIRMAN. They all depend on the lawyers, Mr. Van Alstyne.

Mr. VAN ALSTYNE. I am sorry you said that, sir. That will cost me money. I would like to read a list of companies we have actually financed where the management had the controlling interest in stock.

For instance, we financed the Sonotone Corp. We did its first financing. I do not know if you ever heard of it or not, but back in 1933 we sold $150,000 worth of stock, and it was a little bit of a company.

You would be interested to know it is the largest company in the field of hard-of-hearing today, doing over $10,000,000 worth of business and has $2,600,000 of working capital. It is as direct an instance as you could have where a very small amount of equity money was sold publicly for the benefit of a very small growing company, managed by the people who owned the controlling interest of stock, and it became very successful.

The CHAIRMAN. Now, how much stock did they undertake to sell?

Mr. VAN ALSTYNE. Well, we only sold a very few shares. I think 50,000 shares of common stock at $3 a share. That was the first deal we ever had.

The CHAIRMAN. When you sold that stock, you were not offering to the purchasers any part in the management of the company?

Mr. VAN ALSTYNE. No. The management kept their stock and we sold additional stock of the corporation to bring money into the company.

The CHAIRMAN. So that to sell that stock you had to convince the purchaser of the stock of two things. I am stating this affirmatively, but I mean it as a question. First, that there was an opportunity to make a profit upon the investment.

Mr. VAN ALSTYNE. That is right.

The CHAIRMAN. In other words, that it was a good product with a good market.

Mr. VAN ALSTYNE. That is right.

The CHAIRMAN. Secondly, that the management was efficient and capable of making that profit.

Mr. VAN ALSTYNE. That is right, sir.

The CHAIRMAN. Those were the two primary considerations?

Mr. VAN ALSTYNE. Exactly.

The CHAIRMAN. And those who invested in that stock, therefore, were investing in management and in the conviction that there was a good product with a market.

Mr. VAN ALSTYNE. That is right.

The CHAIRMAN. The management-owners of that enterprise were careful not to offer enough stock to lose the ownership, lose the management?

Mr. VAN ALSTYNE. Lose control; that is right.

The CHAIRMAN. You desire to make the point that that is an example of a type of financing which would be possible through the sale of common stock if common stock on the stock exchange sold at a more equitable price-earnings rate?

Mr. VAN ALSTYNE. You express it perfectly. I would just add, sir, that also included not only stocks listed on the New York Stock Exchange but the vast run of stocks that go over the counter as well.

The CHAIRMAN. Is it your testimony that there are many concerns of that kind?

Mr. VAN ALSTYNE. Well, you mean wanting financing?

The CHAIRMAN. Possibilities of that kind.

Mr. VAN ALSTYNE. I think they grow more and more all the time.

The CHAIRMAN. They are growing right now?

Mr. VAN ALSTYNE. I mean that the opportunities are there. I think there are concerns that would like to finance if they could. I think this great hue and cry to borrow money for small business stems to a certain degree from their inability to do equity financing. As long as I am on that point, may I add one more idea?

The CHAIRMAN. Yes.

Mr. VAN ALSTYNE. I think one of the worst things that any group of life-insurance companies or this Government could do would be to make debt financing too easily available to small business. Now, I say that not for any selfish reason because, as a matter of fact, if I wanted to be very selfish about it, I would like to see it done in vast quantities because those corporations that survive this overdose of debt would be fairly prosperous, and the next step would be to come to houses like ours for equity financing; so that when I make this testimony, I am speaking against, if you wish, my possible future interest.

But one of the worst things you can do to anybody is to make money very easily available particularly on a borrowing basis. I speak from considerable experience, that one of the worst types of financing a banker can engage in is to overfinance a company, so that the management has too much money to play with and they get lax. Many and many a business finds that if it has been tightly held in in its inception, it goes through a hardship which makes it harder and much more easily able to withstand competition in the future.

The CHAIRMAN. You are talking of excessive debt?

Mr. VAN ALSTYNE. Yes, sir.

The CHAIRMAN. Excessive debt, of course, is bad. It is bad for any individual, it is bad for any corporation, and it is only a government that can carry excessive debt because it has the taxing power. I take it you agree with me.

Mr. VAN ALSTYNE. I would not dare disagree with you, sir.

The CHAIRMAN. I do not know exactly how to interpret that statement.

Mr. VAN ALSTYNE. On this point.

The CHAIRMAN. However, the fact remains that some of the soundest investments in the portfolio of many institutions, including life insurance companies, are unsecured loans which are evidenced only by debentures.

Mr. VAN ALSTYNE. But they have a great deal of assets behind them.

The CHAIRMAN. Surely. So that debt, if it is soundly supported by collateral or by earning power, as in the case of debentures, is essential to the economic system, is it not?

Mr. VAN ALSTYNE. I agree.

The CHAIRMAN. We are looking around for ways and means of providing access to the resource of capital for business loans for small businesses. When we do that, we are, of course, assuming that those are to be sound loans and that the debt is not to be excessive. We must make the same assumption with respect to this type of financing that your investors make with respect to the stocks they buy over your counter, the assumption that the business management is good, that the product is good, and the possibility of profit pretty good.

Mr. VAN ALSTYNE. I agree with every word you say, but I think I can point up what I mean in this way.

Periodically there are certain cycles when money is very free and business is fine and general securities business is good; and at that time your banks are feeding money, pleading with industrial companies to please borrow money, and that was very definitely exemplified back in 1945 and 1946 when straight national banks were making term loans up to as long as 10 years, which they had never done before, and there were many instances when it was not a good thing for that money to have been so easily borrowed.

That is the point I make. It would have been much better if those banks had said no, we will only loan you up to 3-year money, and you must have a structure that will support that. That is all I meant.

The CHAIRMAN. Now, your remedy for the situation, the means by which you would promote the sale of common stocks is solely by alteration of the tax laws?

Mr. VAN ALSTYNE. In such a way as I would think it would bring in a great deal more in tax revenue.

The CHAIRMAN. You recognize, of course, that there are different purposes for taxation and that a government must raise its necessary revenue to carry out its policy, whatever that may be, through taxation.

Mr. VAN ALSTYNE. That is one of the unfortunate parts about it. I happen to be one who believes that the purpose of taxation is for the purpose of government and not for the purpose of putting over some philosophy by the government.

The CHAIRMAN. I understand you are a member of the New Jersey Legislature.

Mr. VAN ALSTYNE. Yes, sir; I am president of the senate.

The CHAIRMAN. Then I assume you have no objection to the declaration in the preamble of the Constitution of the United States that we have a national government to promote the general welfare.

Mr. VAN ALSTYNE. I was hoping you would say that, sir, because we all have to agree on that.

The CHAIRMAN. Well, I hear so much about the welfare state these days that I am afraid a lot of people are criticizing the founders of our country without knowing it.

But let's go now to this suggestion of yours. I want to get it clear. Your feeling is that in order to promote the sale of equities in new businesses, in growing businesses, to take advantage of opportunities, it is essential by modification of the tax laws to provide a better market for blue chips, because there would later on come the reaction that would open the door to new stocks that might in their time become blue chips.

Mr. VAN ALSTYNE. I think you have expressed exactly what I have in mind, except I would not say it is the only thing. I do not pretend—there are so many hundreds of economic forces that play on this thing that one thing alone may not do it, and it may, without it.

But the point I want to make is this, sir. The capital-gains tax that the Government has so consistently refused to remove, over 11 years has only averaged an income of $155,000,000, which I think you will agree with me, sir, is a very small amount of money compared with the total sums of money that the Government raises. If it could be reasonably shown—and, of course, you cannot show it mathematically, obviously, because you would only have to try it out—but if the thesis could be advanced substantially that by removing that tax there would be a great stimulation in the type of activity that I have in mind for the definite benefit of the whole economic good, how is it possible not to think in terms of removing it entirely? They have no capital gains tax in Canada or in even socialist England.

The CHAIRMAN. What other incentives would you suggest?

Pardon me. My attention has been called to the table on page 155 of our volume on Factors Affecting Volume and Stability of Private Investment. The estimated taxes on individual capital gains have been rising. For 1942 they were reported at 68 million, for 1943 they were 266 million, for 1944 they were 354 million. For 1945 they were 721 million.

One of the notable things about the evidence presented to this committee has been that in the face of the tax burden—and, of course, it is a tremendous burden—in the face of the Government programs which have produced the most criticism and all of that, there has been the most stupendous advance of prosperity that the country has ever seen. Business is better today than it ever was. Profits are better. Corporate profits, wages and salaries are better. The Federal Reserve Board figures show that the people have been moved from lower income brackets into higher income brackets and that savings have likewise increased.

But so much of the thinking is in terms of what to do to enable the very wealthy, who were the only sources of financing a generation or two ago, to put more of their money into profitable enterprises rather than to pay taxes, and so little attention is being given to creating ways and means of making it possible for the small owners of these new savings to get into the financial market.

Personally, I would like to see them go in as owners rather than as creditors.

Mr. VAN ALSTYNE. I think the first major step has been started some years ago and is increasing in volume in the form of these open-end investment trusts that are being sold, millions and millions every day. Those are being bought by the smaller buyer all over the United States along the highways and byways.

In that way, through these open-end trusts, the small savings are coming into the corporate field, but there at that point those big open-end trusts tend only to buy for the most part the fairly well-known, fairly well-esablished corporations, and they do not buy the smaller type of company stocks that you, sir, have been referring to.

Now so far as this great prosperity is concerned, if you will notice, in my closing statement I refer to insuring the continuance of our present vigorous American economy. I think it is perfectly fantastic the way it has been going, but I would like to call your attention to this, sir.

I notice in the CIO statement this morning it referred to certain periods of time in our economic life and how we had produced such a fantastic amount of goods during the war years.

Well, of course, goods produced in what way? Because the Government loaned the money to practically every corporation and financed it on a capital basis, and that went on. Well, no wonder. That is not normal economy and should be excluded entirely from our thinking.

Then we had this pent-up demand which started to take place. Now, the only point I make is this. As I pointed out, there are only three ways to get a flow of money into capital—debt, retained earnings, and stock financing.

The CHAIRMAN. There is a fourth source.

Mr. VAN ALSTYNE. Is there a fourth source?

The CHAIRMAN. I think so. Savings.

Mr. VAN ALSTYNE. That is retained earnings.

The CHAIRMAN. I thought you were using that in relation to the existing corporations. It is retained earnings of the individual, and if you make the definition broad enough to include that, I accept it, of course.

Mr. VAN ALSTYNE. All I am trying to get at is that in the first place I am not one to say raise depreciation rates on equipment. You would get into an accounting problem that would be indescribable. I am not talking about decreasing corporate taxes. I am talking about—and as Mr. Moore pointed out, you had an increasing scale—I wish you had the figures to show capital gains tax of 1946, 1947, and 1948. You will find they went right down like that.

The point is that if I buy something which is of a fairly hazardous nature, which helps the whole economy of the country, that is the lifeblood. That is the risk capital. If I do that, it is absolutely grossly unfair that on a capital-gains basis, if I have gained money then the Government takes an extra percentage, but if I lose, I lose it all.

The income from that investment very properly should be taxed. I do not quarrel with that for a second. It should be taxed. It should be taxed to whatever extent the Government needs to have money to carry on its business.

Now here is a tax which for 11 years only averaged $155,000,000, and if by removing that one item, which is not a very large amount of money, you could increase and stimulate activity and interest in equity financing, which would finance a tremendous number of these companies we are talking about, and through increased earnings and through increased efficiency bring in much more taxes than that $155,000,000, besides accomplishing much more than that, it would continue to broaden the base.

I do not care what your prosperity is today. You can have the biggest prosperity in the world, but if you do not constantly broaden that base underneath and keep it broadened, you are not going to continue to keep up this prosperity.

The CHAIRMAN. With that I quite agree. We have got to maintain an expanding economy, and if we are going to keep it a private economy, we have to do it by investing more and more private capital into the economy.

Mr. VAN ALSTYNE. That is right. May I continue just a moment, sir?

The CHAIRMAN. Surely.

Mr. VAN ALSTYNE. I am not one that subscribes to—I have read some testimony from different places that the registering of an issue with the Securities and Exchange Commisison is a particular deterrent to financing. I think that is ridiculous.

As a matter of fact, I think in many ways it is a help and a protection for the underwriter to register an issue. I do not think the cost is terrific or too much. I think it could be cut down, and in a supplementary memorandum here I have a suggestion and recommendation as to what I think the act could be changed to even a little bit reduce the cost.

So that with more changes in the machinery, I do not think it is the machinery holding it back, although I know some bankers have taken the position and testified that that type of thing, the registration, does hold back a lot of financing. We have not found it to be so. I just want to cover several subjects so that my point of view is very simple. I do not think this is a very grave problem if one or two simple things would be done.

The other thing is I heard this morning the CIO discussing, poohpoohing this idea of double taxation as being of very negative importance. Well, I will not go into that in detail, but I do think it would also stimulate, and I do not have any figures and I am no tax expert, but I do think that a slight modification there just to give an indication of some assistance without too much change, not obviously eliminate one tax or the other, which would be silly, but some slight assistance to a corporation that pays out larger dividends.

In other words, make a slight incentive that if they do pay out larger dividends, which do pay into the stockholders hands, on which taxes again would be paid, that there would be some recognition either in the form of reduced taxes for the corporation or for the holder of the stock.

The CHAIRMAN. A suggestion was made yesterday afternoon by a witness that there should be a 20-percent dividend received credit.

Mr. VAN ALSTYNE. I think a study of the actual returns, Senator—that is, the tax returns on those two items—should be made before I would hazard a guess whether it should be 5 percent or 20 percent or what. I think the principle is sound.

As far as my recommendations are concerned, they are very simple. I stress, however, that capital gains tax. I think it is the most expensive tax the Government has. I emphasize as strongly as I can that that tax is costing this Government money.

The CHAIRMAN. You also emphasize the inheritance tax law.

Mr. VAN ALSTYNE. Yes; that is really a slightly different problem. That is a problem that is constantly forcing out some of our small family owned companies, forcing them out of existence and forcing them into the hands of their competitors or somebody else.

Frequently these companies fall into the hands of competition, and it is that inheritance tax that tends to work exactly against a good deal of the testimony I have heard and some of the things that I understand this committee and the Small Business Committee is trying to accomplish.

The CHAIRMAN. Now, those are two tax suggestions that you make.

Mr. VAN ALSTYNE. Yes, sir.

The CHAIRMAN. Any others?

Mr. VAN ALSTYNE. No more in the tax line.

The CHAIRMAN. Those are the only two tax incentives that you propose?

Mr. VAN ALSTYNE. That is right.

The CHAIRMAN. Is there any other suggestion that you make?

Mr. VAN ALSTYNE. Well, just in my supplementary memorandum, which concerns the securities laws. They are fairly technical and, to be perfectly honest, I think they are a very minor part of this problem.

The CHAIRMAN. These have to do with reforms of the Federal securities laws and with the activities of State securities commissions?

Mr. VAN ALSTYNE. Yes. Thank you.

THE SECURITIES LAWS IN RELATION TO EQUITY CAPITAL PROBLEMS

I had intended to cover this subject in my original memorandum but the length of the original memorandum exceeded the bounds of propriety, according to information I had, so I deleted it and I have it available in this supplemental form should it be called for.

It seems to me that no discussion of the problems of equity capital would be complete without a brief mention of the existing securities laws.

A. THE SECURITIES ACT

Clearing an issue with the Securities and Exchange Commission, which means the preparation and filing of a registration statement and having it become effective, is a prime requisite to public financing. First, it would be helpful in handling equity financing if amendments could be made to the Securities Act which would permit greater facility in negotiating and underwriting the issue. I refer particularly to arrangements between the underwriters and the company and between the underwriters and the dealers comprising the selling group. It has never been seriously contemplated since the Securities Act has been in existence that its protection was necessary for security dealers themselves (either underwriters or selling group members) who are specialists in their line. It is the public which must have the time to "stop, look, and listen." Accordingly, all unnecessary impediments to the underwriting of the deal should be removed. By permitting contractual relations between the underwriters and the selling group members in advance of the effective date of the registration statement, the offering can be made more expeditiously, the risk of loss attendant upon underwriting will be spread over a greater number, and consequently, equity money can be obtained more readily and more cheaply.

The second suggested amendment relates to simplification of the prospectus, both as to its size and contents, and also the present requirements for its continued use. I believe it can be demonstrated very easily that in its present form the prospectus is really of little use to the public. If the registration statement could be filed, containing a prospectus which could be made available on request, but the document to be delivered to a prospective purchaser be limited to a simple selling circular not to exceed six or eight pages, consisting primarily of a synopsis or summary of the more essential parts of the prospectus, it is quite likely that this would be read. I submit that if such circulars were put out under the supervision of the Securities and Exchange Commission they would be required to present an accurate picture of the highlights of the offering, leaving it to the purchaser to ask for a full prospectus if he wanted it. Moreover, it should only be necessary to use a prospectus during the period of original distribution, say for 30 days following the termination of the selling group.

Thirdly, I would suggest the inclusion of another category of securities which could be offered on a simplified registration. Now only securities up to $300,000 in aggregate offering price can be offered under the short-form registration which requires nothing more than filing with the SEC a notice of intention to offer on a very short specified form. It seems to me that it would be feasible to permit securities in amount between $300,000 and say a million or a million and a quarter dollars to be registered on the same short form but requiring in addition a simple selling circular with some financial information. The purpose is to eliminate the long-form registration with its costly charges for accounting fees, legal fees, and printing expenses on deals of such size that it makes the cost of financing too expensive.

Finally, I think section 16 (b) of the Securities Exchange Act should be overhauled. By the number of exemptions that the Securities and Exchange Commission has granted, it might be advisable to consider redrafting this section in its entirety in the light of actual experience. In any event, another exemption should be provided by legislation as it is doubtful if the Commission has power to itself grant the exemption by rule. At times it is necessary, particularly in the case of the financing of a new venture, for an underwriter to have a representative on the board; at other times, because of particular knowledge the company itself requests that the underwriter place a representative on the board. In both of these instances if the underwriter accepts a position on the board, it is effectively prevented from having any part in making a market for the company's securities. This is a hardship in any case but becomes more pronounced in the case of a new issue.

I believe that it is the duty of an underwriter to maintain at all times a market for the stock of a company which it has sponsored to the public, in order that stockholders who wish to do so can have an opportunity of selling. Obviously the underwriter must sell the stock it so acquires without awaiting the lapse of 6 months or it will be accused of manipulating the market by accumulation, assuming it had the capital with which to do so. Accordingly, it is not fair to make the underwriter absorb the losses but yet be required to account for any profits it may make. Very few, if any, of these transactions can be handled on an agency basis; the underwriter will probably be forced to act as a principal.

Accordingly, it seems to me that where the partner of the underwriter, who is a director, has less than a 50-percent interest in his firm, so that other partners who are not directors of the issuing corporation share in any such profits, exemption for such transactions of the firm should be afforded.

The SEC itself has in effect recognized the merit of this position. It is my understanding the Commission has looked with favor on settlements made between underwriting firms and issuing corporations where this situation has arisen by permitting the underwriting firms to account to the issuing corporation for a percentage of its profit equal to the percentage interest of the partner in the firm who is a director of the corporation. Likewise, the SEC has granted an exemption from the provisions of section 16 (b) in the case of original underwriting where the representative of the several underwriters has a partner on the board of the issuing corporation, provided such underwriter does not have more than a 50-percent interest in the underwriting. In other words, the purpose of this section is to prevent the unfair use of information obtained by reason of the relationship of the partner to the issuer. To an extent the danger of the nonaccomplishment of this purpose must yield to the practical aspect of permitting the underwriting firm to have a director of the issuing corporation and yet be able to make a market in its securities. The making of such a market is not undertaken with the primary purpose of profit by the use of inside information.

I have reason to believe the SEC itself is not adverse to these amendments.

B. State securities commissions

Here we come into a field where your committee has no jurisdiction, but nevertheless it should be touched upon. It is a costly and slowing-up process and really involves, for the most part, duplication to get an issue cleared under the "blue sky" laws of the several States. Of course, a number of States have cooperated to the extent of accepting a Federal registration statement as the equivalent of supplying the information required to be filed with them in lieu of using their specified forms. This is not true with all States and at least this much would be helpful if made uniform. But it is only a part of the problem. A good many State laws are not framed on the theory of disclosure and truth in the prospectus but give the local securities commission jurisdiction over the merits of the deal itself. This is a clash of two schools of thought and frequently meritorious deals are forbidden in certain States because of the prejudice of the local commissioner or his examiner. The only suggestion I can make here would be the enactment of legislation which would make clear the intent of the Congress that the sale in interstate commerce of securities which have been registered with the Securities and Exchange Commission is a federally preempted field of legislation. In other words, irrespective of the action of the local State commission, as long as these sales are confined in their making to the use of the mails and instruments in interstate commerce and without personal solicitation, they should not be prevented.

I would say in my opinion that these changes about the securities laws are probably 2 or 3 percent of the problem and these other things are the balance. I put it in that percentage.

The CHAIRMAN. Mr. Scoll?

Mr. SCOLL. Mr. Van Alstyne, as far as the investor is concerned who is already in a personal income-tax bracket over 25 percent, isn't the capital-gains tax an advantage when it comes to investment decisions? He can reduce his tax rate and get a lower tax rate if he is able to manage his investments in such a way as to produce capital gains, so that he only has to pay a 25-percent tax, say, instead of a 40-percent tax, for instance.

Mr. VAN ALSTYNE. You are assuming, as I understand it, that capital gains would be taxed at the normal rate. I say they should not be taxed at all, not for anything, no matter what income-tax bracket you are in.

Mr. SCOLL. Now, you mentioned one company with a flotation of $150,000 in 1933. Have you handled any equity flotations for any companies for that amount in the last 3 years, say in the years since the war?

Mr. VAN ALSTYNE. No.

Mr. SCOLL. Well, generally speaking, what has been the size of flotations that you have handled recently?

Mr. VAN ALSTYNE. From $500,000 to $5,000,000.

Mr. SCOLL. Nothing under 500,000 in recent years?

Mr. VAN ALSTYNE. Recently?

Mr. SCOLL. Yes.

Mr. VAN ALSTYNE. That is right.

Mr. SCOLL. Would you object to submitting that list of your flotations for the record?

Mr. VAN ALSTYNE. Not at all. May I send you a copy? This is the only copy I have at the moment.

Mr. SCOLL. Yes, if you will do that.

(The list referred to above is as follows:)

Underwritings, 1933–48

1933–40

Date of offering	Description of issue	Price to public	Dollar amount
July 1933	Sonotone Corp., 50,000 shares common stock	$3.00	$150,000
March 1934	Dodge Cork Co., Inc., 25,000 shares capital stock	6.50	162,500
August 1935	Sonotone Corp., 40,000 shares cumulative convertible preferred stock with common stock option warrants and sinking fund.	10.00	400,000
November 1936	Atlas Plywood Corp., 70,000 shares cumulative convertible preferred.	25.00	1,750,000
December 1936	Thermoid Co., $2,450,000 first lien collateral trust 5's due Dec. 15, 1951 (with stock purchase warrants and sinking fund).	100.00	2,450,000
February 1937	Burd Piston Ring Co., 60,000 shares common stock	12.50	750,000
April 1937	Brewster Aeronautical Corp., 187,500 shares capital stock	5.50	1,031,250
Do	American Forging & Socket Co., 40,000 shares common stock.	13.50	540,000
May 1937	Struthers Wells-Titusville Corp., $1,550,000 first mortgage 5½-percent sinking fund bonds due Apr. 1, 1949 (with detachable stock purchase warrants).	100.00	1,550,000
September 1937	Emerson Electric Manufacturing Co., 40,000 shares common stock.	11.25	450,000

Underwritings, 1933–48—Continued

1933–40—Continued

Date of offering	Description of issue	Price to public	Dollar amount
December 1937	Emerson Electric Manufacturing Co., 77,754 shares common stock.	[1] $6.00	$466,452
October 1938	Atlas Plywood Corp.. 5.500 shares common stock	[1] 18.00	99,000
April 1939	Brewster Aeronautical Corp., 50,000 shares common stock.	[1] 9.00	450,000
July 1939	Continental Motors Corp., 126,348 shares common stock	[1] 3.00	379,044
September 1939	Brewster Aeronautical Corp., 22,518 shares common stock.	[1] 8.50	191,403
November 1939	Continental Motors Corp., 350,000 shares common stock	[1] 3.875	1,356,250
June 1940	Continental Aviation & Engineering Corp., 260,000 shares common stock.	3.25	845,000
	Total for years 1933–44		13,020,899
	1944		
January 1944	Atlas Plywood Corp., 150,000 shares common stock	$11.875	$1,781,250
March 1944	Diana Stores Corp., 80,000 shares common stock	7.00	560,000
April 1944	National Container Corp., $4,500,000 5 percent 15-year sinking fund debentures due Apr. 1, 1959.	100.00	4,500,000
June 1944	The Drackett Co., $1,500,000 5 percent 15-year sinking fund debentures due June 1, 1959.	100.00	1,500,000
Do	The Drackett Co., 85,000 shares common stock	8.00	680,000
August 1944	Buffalo Bolt Co., 141,054 shares common stock	6.00	846,324
September 1944	Solar Manufacturing Co., 90,000 shares Series A convertible preferred.	10.00	900,000
October 1944	Allen B. DuMont Laboratories, Inc., 225,000 shares class A common stock.	7.375	1,659,375
November 1944	Franklin Stores Corp., 200,000 shares common stock	8.00	1,600,000
	Total		14,026,949
	1945		
January 1945	American Phenolic Corp., $1,500,000 5-percent 15-year convertible sinking-fund debentures due Dec. 15, 1959.	$100.00	$1,500,000
Do	American Phenolic Corp., 345,000 shares common stock	10.00	3,450,000
March 1945	Solar Manufacturing Corp., 50,000 shares common stock	8.50	425,000
May 1945	Expreso Aero Inter-Americano, S. A., 300,000 shares common stock.	3.00	900,000
Do	Kobacker Stores, Inc., 55,781 shares cumulative preferred stock.	25.00	1,394,525
Do	Kobacker Stores, Inc., 175,000 shares common stock	9.00	1,575,000
July 1945	National Container Corp., 100,000 shares 4¾-percent cumulative convertible preferred.	26.00	2,600,000
August 1945	Seaboard Finance Co., $3,000,000 5-percent 10-year sinking-fund debentures due Aug. 1, 1955.	100.00	3,000,000
Do	Seaboard Finance Co., 70,000 shares series A cumulative preferred stock.	30.00	2,100,000
September 1945	Solar Manufacturing Corp., $1,500,000 5-percent sinking-fund debentures due Aug. 1, 1960.	100.00	1,500,000
Do	Olympic Radio & Television, Inc., 100,000 shares common stock.	5.75	575,000
Do	Adam Hat Stores, Inc., 100,000 shares common stock	8.50	850,000
November 1945	Angerman Co., Inc., 90,000 shares common stock	8.00	720,000
	Total		20,589,525
	1946		
January 1946	The Pantasote Co., 100,000 shares common stock	$5.75	$575,000
February 1946	Buffalo Bolt Co., 43,386 shares common stock	14.00	607,404
Do	Regal Shoe Co., 300,000 shares common stock	6.00	1,800,000
March 1946	Burry Biscuit Corp., 100, 000 shares $1.25 convertible preferred stock.	26.50	2,650,000
April 1946	The Drackett Co., 108,000 shares 4 percent cumulative convertible preferred series A.	25.00	2,700,000
Do	Sonotone Corp., 60,000 shares $1.25 cumulative convertible preferred stock, series A.	25.00	1,500,000
May 1946	Allen B. DuMont Laboratories, Inc., 425,000 shares, class A common.	11.00	4,675,000
June 1946	Namm's, Inc., 100,000 shares common stock	11.00	1,100,000
July 1946	American Airways, Inc., 100.000 shares common stock	9.75	975,000
October 1946	Fownes Bros. & Co., Inc.. 100,000 shares capital stock	9.50	950,000
December 1946	Fashion Frock, Inc., 60,000 shares common stock	9.00	540,000
Do	Seaboard Finance Co., 200,000 shares common stock	16.00	3,200,000
	Total		21,172,404

[1] Approximate.

Underwritings, 1933–48—Continued

1947

Date of offering	Description of issue	Price to public	Dollar amount
January 1947	The Pantasote Co., 50,000 shares common stock	$11.25	$562,500
March 1947	Empire Millwork Corp., 125.000 shares common stock	8.75	1,093,750
June 1947	Bowman Gum, Inc., 268,875 shares common stock	7.125	1,915,734
July 1947	Atlas Plywood Corp., 72,882 shares common stock [2]	32.00	2,332,224
	Total		5,904,208

1948

Date of offering	Description of issue	Price to public	Dollar amount
February 1948	Hayes Manufacturing Corp., 185,000 shares common stock [2]	$7.50	$1,387,500
August 1948	Allen B. DuMont Laboratories, Inc., 150,000 shares 5 percent cumulative convertible preferred [2]	20.00	3,000,000
Do	Continental Motors Corp., 300,000 shares common stock [2]	7.50	2,250,000
	Total		6,637,500
	Grand total		81,351,485

[2] Underwritten by the corporation.

Mr. SCOLL. Now, as far as the flotation of an issue for an amount smaller than $500,000 is concerned, approximate handling of such an issue, are there any reasons that you can ascribe to why you have not handled such issues in the last 2 or 3 years?

Mr. VAN ALSTYNE. One of the principal reasons, I would say that to a very considerable extent the size issue, the thing that determines the size issue that we put out is the marketability of the issue after it is in the hands of the public. Over a period of some years, at least, we have arrived at the point of view that there should be a minimum of 100,000 shares of stock in the hands of the public distributed before you can consider that it will develop a market of its own.

Mr. SCOLL. A hundred thousand shares in number? You do not mean a hundred thousand dollars?

Mr. VAN ALSTYNE. I mean 100,000 shares. Whereas, we recognize fully the responsibilities of an underwriting house to assist in making a stable market in stock, at the same time we do not want to make it forever, and if you put out a smaller issue than that, then it just does not develop a market of its own. Other people do not get interested in it. We found that is about the minimum over a period of time.

Now, on the other hand, if that particular company happens to have stock already in the hands of the public, we have a number of times sold less than a hundred thousand shares of additional amount of stock.

Mr. SCOLL. So that in effect you find the public acceptance of a small issue is not such today as would make it worth your while or the companys' while to try to float a small issue?

Mr. VAN ALSTYNE. That is right. When you can go to the New York Stock Exchange or go to the over-the-counter market and invest your money anywhere in very excellent companies, anywhere from 7 to 13 percent, and have immediate liquidity on the New York Stock Exchange or in some cases over-the-counter market, there is very little incentive to try to sell a very small issue at any terms that would not be completely prohibitive.

In fact, almost at any price. It is an interesting thing to note that with all this tremendous activity we had in underwriting issues over a period of time, so far in 1949 we have yet to underwrite a single issue.

Mr. SCOLL. Any at all?

Mr. VAN ALSTYNE. Not one.

Mr. SCOLL. Now, have any of the companies other than companies which you have already financed in the past, approached you in the last 3 years or the years since the war, to underwrite a small issue of common or preferred stock?

Mr. VAN ALSTYNE. In spite of the fact that we have not underwritten anything this year, I do not suppose there is a week that has gone by that we have not discussed the possibility with some of the companies we have financed in the past or new companies, but in each case the terms are so onerous. Take the Buffalo Bolt Co., one of the largest companies in the United States in the manufacture of bolts, nuts, and other articles. They own, I think the largest power lawnmower company in the country, too. It is a fine company.

It does a business of approximately 14 millions a year, their net working capital is 6½ millions. This year it is earning about $2.50 a share. It was paying dividends at the rate of $1.50, and the stock was selling around 14; and, therefore, it yielded around 10½ to 11 percent.

The company does not have too big a debt, something like $1,200,000. They would like to sell stock to clean up the debt and put themselves in good shape. But they would not think of selling stock. It is not possible. It does not make sense, because we would have to have some bankers' discount and the cost to the company—that is, on a return basis—would be 12 percent on the actual dividends, not to speak of the fact that they would be selling stock at probably only 4½ times actual earnings. That is what I mean.

Now, if that stock were in proportion to other stocks, it should be selling on a 6 percent return basis and on, say an 8 or 10 times earnings basis, and if that were the case, there would immediately be a stock issue.

Mr. SCOLL. Your point being that at current rates, that would in effect be a dilution of the existing equity which the management and the existing stockholders do not want to take.

Mr. VAN ALSTYNE. That is right.

The CHAIRMAN. Does a small company of that kind in your experience ever secure any capital from employees?

Mr. VAN ALSTYNE. I never heard the matter discussed, Senator.

The CHAIRMAN. The profit-sharing idea has grown considerably in recent years, and I have known of some instances in which small businesses have arranged to allow employees to acquire an ownership stake in the business. I have often thought that substantial small businesses, which do have a high earnings ratio like that company you have just mentioned, the stability of which must be known to the workers, might find those workers so far as they are also savers, to be a source of equity capital.

Mr. VAN ALSTYNE. Well, I think that is an interesting point of view, and I have been a director of a number of companies where we had profit-sharing plans. As a matter of fact, I am a great believer in the profit-sharing plan.

Unfortunately, we find, it has been my experience that labor, at least as represented by their leaders, seems to prefer to get the money instead of reinvesting money in the company and getting a return on that. At least, that is the experience I have had.

The CHAIRMAN. Well, there is so much thinking on every side in terms of the company on the Big Board and the stock on the Big Board and the stock that goes over the counters of dealers in central money markets that perhaps not enough attention is given to this other possibility. I think that the experiment of the American Research & Development Corp., for example, and of similar companies is an attempt to enter into this general field of which I am speaking, the small savers, the great multitude of whom would provide a vast reservoir that apparently is as yet untapped.

Mr. VAN ALSTYNE. Of course, as I understand that American Research & Development Corp., it has a Boston headquarters; is that right?

The CHAIRMAN. Yes.

Mr. VAN ALSTYNE. That covers a little different field.

The CHAIRMAN. It does, of course.

Mr. VAN ALSTYNE. It is still a different situation. I believe that if normal stock prices—and you will ask me what is normal, and I fudged it in my memorandum, I do not know what normalcy is—but in any event, if the yield on common stocks and the price times earnings ratio got to something like it used to be, this is an astounding situation with this tremendous prosperity you spoke of, this tremendous prosperity, it is inconceivable that we would ever have such prosperity in peacetime, and yet the only thing that has not inflated is stock prices.

If we even had it partially up, I think it would open the way to financing a great deal of comparatively small amount of equity financing along the lines that you are talking about. In fact, I am very bullish on the thought.

Now, as a matter of fact, if I may just say a word about my personal interest in the thing, we could have gone the way of 99.9 percent of the houses in Wall Street and dealt almost entirely in the 3 percent bonds and all this kind of stuff, but frankly, it does not interest me. I like to finance companies and help them grow. That is primarily the reason we do it. It may sound funny, but it is a fact. Just the plain buying and selling of high-grade bonds to make a quarter of a point or something has never interested me.

The CHAIRMAN. Do you not think then, Mr. Van Alstyne, that there is a great opportunity for salesmanship without even these changes of the tax laws of which we speak?

Mr. VAN ALSTYNE. You just cannot buck up against the inevitable.

The CHAIRMAN. You have been doing it; have you not?

Mr. VAN ALSTYNE. No; not since these present stock market conditions have existed. We had to stop.

The CHAIRMAN. How long has it been since you have floated a stock issue?

Mr. VAN ALSTYNE. The last issue we sold was 300,000 shares of Continental Motors Corp. common stock on August 19, 1948, at 7½. That was $2,250,000. In that year, 1948, we only had three issues.

The CHAIRMAN. Of course, Continental Motors was not a new enterprise.

Mr. VAN ALSTYNE. That was additional stock to take care of expansion. They did not want to sell stock. It represented a dilution, but it seemed essential to do that.

Then I understand Dr. Du Mont was here a few days ago. We have done the recent financing for the Du Mont Laboratories.

In that same summer of 1948 we sold $3,000,000 of Du Mont Laboratories 5-percent convertible preferred stock. But, of course, there was a unique situation. I do not suppose there is a better known name in its field in the United States in probably the most rapidly growing industry, so there was a special circumstance which enabled us to do that financing.

The point I make, sir, is that we have not done a single new issue since August 19, 1948, which is 15 months ago, and I doubt very much if we will be able to do any unless prices of stocks in relation to earnings and yields are more normal.

The CHAIRMAN. I think I interrupted you, sir.

Mr. SCOLL. No; you did not.

Assume a continuation of this condition in the stock market you are speaking of, and assume also that no change is possible in the capital-gains tax or if the change were made, that it did not produce the results you would like to see; on those two assumptions what do you suggest this committee might do, or what do you recommend to the committee to aid in providing capital for expansion for the enterprises that would be shut out of capital markets, continue to be shut out of the capital markets under the condition you have oulined? Is there anything you think can be done?

Mr. VAN ALSTYNE. You are referring, Mr. Scoll, to small business, so to speak?

Mr. SCOLL. I am referring to situations such as that which existed in the case of Du Mont when it went for its first public financing about 7 or 8 years after it was in existence, and I think you were its investment banker at that time, and I think you aided them in obtaining financing.

Mr. VAN ALSTYNE. We came in second. Although we financed them three times, we only started, I think, 4 years ago.

Mr. SCOLL. I am thinking about the situation where the owners of the business bring it through the first stages of establishment, get it to the point where it has prospects, but only a meager earnings record, and in addition to prospects, it has management, but it does not have the finances it requires to put it over, so to speak, to get its first big growth.

As you have indicated, such capital is not now available in the market. If it continues to be unavailable, do you believe that there is any form of help that could or should be provided?

Mr. VAN ALSTYNE. Taking that particular instance, that help that you speak of was not available to Du Mont even back when the markets were fine and you could sell common stock fairly readily, because it was still such a tremendously speculative venture. Dr. Du Mont would be the first to tell you that back in those days it was very speculative and very uncertain that he had something that might be commercial in any reasonable period of time.

I think that is where the type of organization the Senator mentioned awhile ago, the American Development & Research Co., comes in. That would have been a wonderful place for them to put some of their funds—private capital that can afford to take a risk on a new venture of that kind. I think we should stress that. I would be very reluctant on a new semipromotional venture—that is, something of a scientific nature that may or may not work out—to sell it to the public. I think those risks should be taken by private capital. When you come to the point where you are talking about a smaller company with earnings but yet is of such size that they cannot get capital—is that it?

Mr. SCOLL. I was thinking of both situations.

Mr. VAN ALSTYNE. I have answered the first point. That is my opinion.

On the second point I think it is very difficult. I would certainly subscribe to the idea that some of those companies could be helped by making loans available to them, provided the loans were held down to a size that they could readily digest, and I use the word "digest" advisedly, because sometimes the enthusiasm of the ownership for the business tends to have them borrow too much; but I do not know any answer to financing them through common stocks until this normal relationship comes back, the normal relationship I have been harping on, comes back. I do not know the answer to that.

The CHAIRMAN. Dr. Kreps?

Mr. KREPS. Pursuing Mr. Scoll's question still further, I have been interested to hear you describe this present period of prosperity as one of vigor and a little further along in your testimony as being inconceivable, at least a few years ago.

Mr. VAN ALSTYNE. In peacetime.

Mr. KREPS. Yes; in peacetime. Now, it is a period in which stock prices are around 8 times earnings in general, a little less. There has been one previous period of the same kind, 1920. I have been trying to find what would be a normal ratio. It has been as high as 25 to 30 times earnings. The period of 1938 you just spoke of was a time in which it was nearly 25 times earnings.

Mr. VAN ALSTYNE. I have said 1936.

Mr. KREPS. In 1936 it was about 16 times earnings.

Mr. VAN ALSTYNE. What stocks are you referring to?

Mr. KREPS. Industrials.

Mr. VAN ALSTYNE. That is an average of all industrials?

Mr. KREPS. Yes.

Mr. VAN ALSTYNE. That jibes with what I said. I said 8 to over 20 times, depending on the situation of the company.

Mr. KREPS. There are two ways you can get stocks to sell at 16 times earnings. One is the one you have been suggesting here, to assume that this period of prosperity is normal, that these earnings will last, and then that stock prices ought to go up. Now, the other assumption might be that this is a period of relatively great, or indeed unbelievable, prosperity and that there may be shortly ahead a reversion to a period such as we have experienced at other times in the economy of drastically low earnings. Suppose corporate earnings should go down by 50 percent.

You would get stocks at present prices selling at 16 times earnings. Would you regard that such a period of depression as one which would be favorable to the development of new enterprise and sale of equity capital?

Mr. VAN ALSTYNE. Yes. All I am talking about is getting the price of stocks in normal relation to earnings and yields. Whether the earnings of the corporations go down and the stocks stay approximately as they are, or whether the reverse process takes place.

Mr. Kreps. I judge the difference is one between a bull and a bear; isn't it?

Mr. Van Alstyne. All right. I will accept that.

Mr. Kreps. That is why I took industrials because this is a situation which applies almost wholly to industrials.

Mr. Van Alstyne. The reason I keep emphasizing industrials is because it is possible to sell public utility common stocks today, and there has been a great deal of financing.

The Chairman. Why?

Mr. Van Alstyne. Because public utility common stocks are selling on a fairly normal yield basis between 5, 5½, 6, 6½ percent, and they sell on approximately 8 to 10 or 11 times earnings basis.

Mr. Kreps. Seven and one-half percent yield is about 13 times earnings.

Mr. Van Alstyne. Well, that is even better. So I took industrials as the subject that is the problem. But how can you expect to sell a new issue of stock of a comparatively new company when you can buy Douglas Aircraft common? Douglas Aircraft is one of the best companies I know of, and the yield is 13.8 percent on your money.

Mr. Kreps. May I suggest probably what you need to do is to educate the bears that seem to see ahead a period in which earnings are likely to fall.

Mr. Van Alstyne. Unfortunately, I happen to be of a fairly optimistic nature, and I am not very good at that kind of education.

The Chairman. Let me interrupt to revert to our little discussion about the capital gains tax and receipts therefrom. I cited to you the figures appearing in this monograph of ours. The last figure we had was 1945, and you remarked that if we had the figures for the succeeding years, the return would have been shown to have fallen off tremendously. We made an effort to find out through the staff of the Joint Committee on Taxation what the situation is. That committee has not yet calculated the tax receipts, but it does have the figures on the income reported, income reported from capital gains, and that is as follows: 1945, $2,200,000,000.

Mr. Van Alstyne. Capital gains?

The Chairman. That is what Mr. Moore reports to me. Not tax receipts, now. This is the base of the tax.

Mr. Van Alstyne. The base of the tax? Excuse me.

~~The Chairman. $2,200,000,000. In 1946 there was a big increase,~~ $3,200,000,000. In 1947 it was a drop back almost to 1945 but not quite, $2,320,000,000. I just thought those figures ought to go in.

Mr. Van Alstyne. All I want to say is I got these figures from Mr. Hopkinson, a partner in Drexel & Co., and he said he got them from the Internal Revenue, and if they are not right, it is not because my intentions were not correct.

The Chairman. We know that.

Mr. Kreps. I have one or two more questions.

I take it you are not trying to tell us that the ratio of stockholder equity to total assets today is appreciably different from what it was in the past.

Mr. Van Alstyne. Ratio of——

Mr. Kreps. Stockholder equity to total assets. That is not appreciably different today from what it was in the past, but the method by which capital is accumulated today is from internal earnings rather than the stock market.

Mr. SCOLL. You mean debt equity ratio?

Mr. KREPS. Yes.

Mr. VAN ALSTYNE. If you are referring to the very large corporations, I would agree.

Mr. KREPS. That is all corporations. Here is a table on page 110 of the committee print on Factors Affecting the Volume and Stability of Private Investment. Here is what you find. The ratio of stockholder equity to total assets was 71.6 in 1926, 70.7 in 1936, and 70.2 in 1946. In other words, that ratio is practically identical all 3 years, although quite clearly the percentage of increase in stockholder equity due to retained earnings has been enormously increased in the last couple of years.

Mr. VAN ALSTYNE. You only follow up through 1946.

Mr. KREPS. There are no data after that time.

Mr. VAN. ALSTYNE. I am not criticizing. I am bringing out the point that the condition I am referring to now, where you cannot finance through equity, has only existed primarily in the last 2 years or 2½ years, and the record, the actual statistics of industrial common-stock financing, definitely bears out what I have been talking about. It has been a very small amount in the last 2 years.

Mr. KREPS. These figures for that are not available. We do know that the amount of undistributed earnings has been extraordinarily large in those 2 years.

Mr. VAN ALSTYNE. That is right.

Mr. KREPS. I have one further question. We seem to have come to this present vigorous stage of the American economy in the face of all these tax deterrents. There are some who feel that we had a period of inflation, part of it due to enormous business and investment expenditures. I am not prepared to say whether they were excessive or in how far they were, but I am prepared to say that we would like to see something like stability in these expenditures.

We hate to see them fluctuate from high levels such as they were in 1948 and 1949 down to drastically low levels. If such tax deterrents operated without discrimination as between companies, as between size of firms, as between industries, might it not have been lucky for the economy that we had some of these deterrents in 1947, 1948, and 1949 in the interest of stability?

Mr. VAN ALSTYNE. Well, I will tell you, sir, you certainly have put a good one. I do not pretend that I could answer that question. I doubt if there is anybody alive that could answer that question.

Mr. KREPS. We always ask questions of expert witnesses which we cannot answer ourselves.

Mr. VAN ALSTYNE. I would like to answer it as I think I answered the Senator awhile ago. I have referred in my memorandum here to a present vigorous economy, and nobody can say it is not true, but I also say, and economic history tends to prove this present statement I am about to make, that you cannot have a continuing vigorous economy under a capitalistic system unless you have a free flow of new capital in the system, in one form or another. History tends to show also that you tend to have more prosperity in ratio as you are able to strengthen your base through equity financing of common stocks.

All you have to do is read the history of the United States from an economic standpoint to prove that point. All I am saying is it is my belief that we will not continue this vigorous economy that we now have or increase it unless we are able to have a free flow of capital by means of common-stock financing.

Mr. KREPS. I share the belief that a vigorous domestic private-capital-investment flow, as stable as possible, is necessary for high and sustained levels of employment. I agree with you. Thank you very much.

I have no further questions.

The CHAIRMAN. I think perhaps it might be added that in addition to the free flow of investment, as I think you have well stated, there must be at the same time constantly expanding markets, because if you do not have the market, if you do not have the purchasing power, there is no basic incentive for investment at all.

Mr. VAN ALSTYNE. That is right.

The CHAIRMAN. We are very grateful to you, Mr. Van Alstyne, for your appearance here and for your very frank discussion of the issues. I think this free exchange of opinion and analysis is beneficial all around.

Your supplementary memorandum on various phases of the SEC law and of the operations of State securities commissions has brought to my attention a memorandum which was prepared for this committee in collaboration with the staff by Mr. Charles H. Schmidt, economist of the Division of Research and Statistics of the Board of Governors of the Federal Reserve System. A questionnaire, prepared by the staff of this committee, was sent to companies which had registered securities issues with the Securities and Exchange Commission and which subsequently altered their plans and withdrew their registration statements.

An effort was made to find out why that change in plans had been made. The subcommittee was able to secure the cooperation of the Federal Reserve Board, and its staff, in analyzing the questionnaires and in preparing a report based upon it. I think it would be altogether proper in view of your discussion of a similar issue that this memorandum should be made a part of the record at this point.

(The memorandum referred to above is as follows:)

UNSUCCESSFUL POSTWAR SECURITY FINANCING[1]

(By Charles H. Schmidt[2])

The Joint Committee on the Economic Report, cognizant of the widespread interest and concern regarding the need for, and disposition of, investment funds—particularly equity capital—has undertaken a series of hearings and otherwise endeavored to assemble current data and opinion relevant to the problem. As one aspect of its investigation the committee obtained from the Securities and Exchange Commission the names of all concerns that registered proposed security offerings with the Commission during the period 1946–48 and subsequently, for one reason or another, withdrew these registrations. The committee addressed a questionnaire (see appendix A for Description of Questionnaire and Respondents, and appendix B for forms of Letter of Transmittal and Question-

[1] For advice and consultation in the drafting of this report, the author is indebted, in addition to the staff of the Joint Committee on the Economic Report, to the following persons: Ralph A. Young and Albert R. Koch, Board of Governors of the Federal Reserve System; Edward T. McCormick, Jerome S. Katzin, and Maurice C. Kaplan, Securities and Exchange Commission; Burton Klein, Council of Economic Advisers; and Irwin Friend, Department of Commerce.

[2] Economist, Division of Research and Statistics, Board of Governors of the Federal Reserve System.

naire) to each of these registrants for the purpose of obtaining information about the type and purpose of the proposed security offering; nature of underwriting agreement, if any; reasons for withdrawal of registration statement; availability and character of alternative financing employed; repercussions of failure to market proposed security issue; and suggestions for enhancing ability of corporations to finance their long-term capital requirements from external sources. Replies were received from approximately three-fourths of the registrants queried; of these, approximately two-thirds were usable in preparing parts or all of this report.

SUMMARY OF FINDINGS

1. The proportion of the total number of securities registered with the Securities and Exchange Commission and subsequently withdrawn was about the same during the postwar period (July 1945–June 1948) as it was during the war period, and well below that of the prewar period. That the postwar withdrawal experience was not particularly unfavorable is also indicated by the fact that the average annual dollar volume of corporate securities issued for new money in 1946–48 was substantially larger than that in either of the earlier periods cited.

2. Many different reasons for withdrawal of registration statements were advanced by those who replied to the committee's questionnaire, ranging from security-market conditions on the one hand to purely technical reasons on the other. However, in roughly three out of five cases market conditions were cited as the major reason for the respondents' withdrawal of their proposed security offerings. Many registration statements were filed at or near peaks in the general level of stock prices, with the result that when prices fell, in some cases very sharply, registrants found it disadvantageous to proceed with their offerings. Many of these proposed security issues were never actually offered for sale, but were withdrawn upon the advice of underwriters or on the companies' own initiative in view of general security-market conditions and sentiment. Others were withdrawn only after the registrant had tried unsuccessfully to sell the security.

3. Many respondents indicated that they were seeking funds to finance an expansion of their productive facilities or a larger volume of current operations. Of the 89 respondents who registered proposed common or preferred stock offerings to finance expansion, one-third succeeding in financing their requirements in full from alternative sources; one-third were partially successful in such alternative financing, and only one-third obtained no additional funds from any source whatsoever. Of those companies that failed to obtain any funds, most continued operations, albeit on a more restricted scale than contemplated, only a few being forced to suspend operations entirely or to seek relief through bankruptcy proceedings.

4. Smaller companies, those with total assets of less than 10 million dollars, experienced somewhat greater difficulty in obtaining adequate financing from alternative sources than did larger companies. However, there were some smaller companies that succeeded in financing their requirements in full from alternatives sources, and a somewhat larger number that were at least partially successful in alternative financing.

5. Only one-half of the registrants whose replies proved analyzable offered any concrete suggestions as to how to improve business opportunities for obtaining equity capital from external sources. Of those that made suggestions, the majority singled out Federal income-tax revision as being of primary importance, including elimination of what they termed double taxation of corporate profits and reduction of corporate and personal income-tax rates. Some suggested simplification of SEC registration requirements and procedures in order to expedite filing and review of registration statements.

6. Of the 125 respondents who furnished complete information requested by the committee, approximately one-fifth mentioned complexities and delays involved in the registration procedure and SEC objection to their proposed security offering as reasons for withdrawing registrations. Review of their files by staff members of the SEC revealed that most of these registration statements contained material misstatements and omitted essential facts, and that delays were more often the result of the registrants' failure to supply information required by law than of the Commission's failure to expedite review of the registration statement.

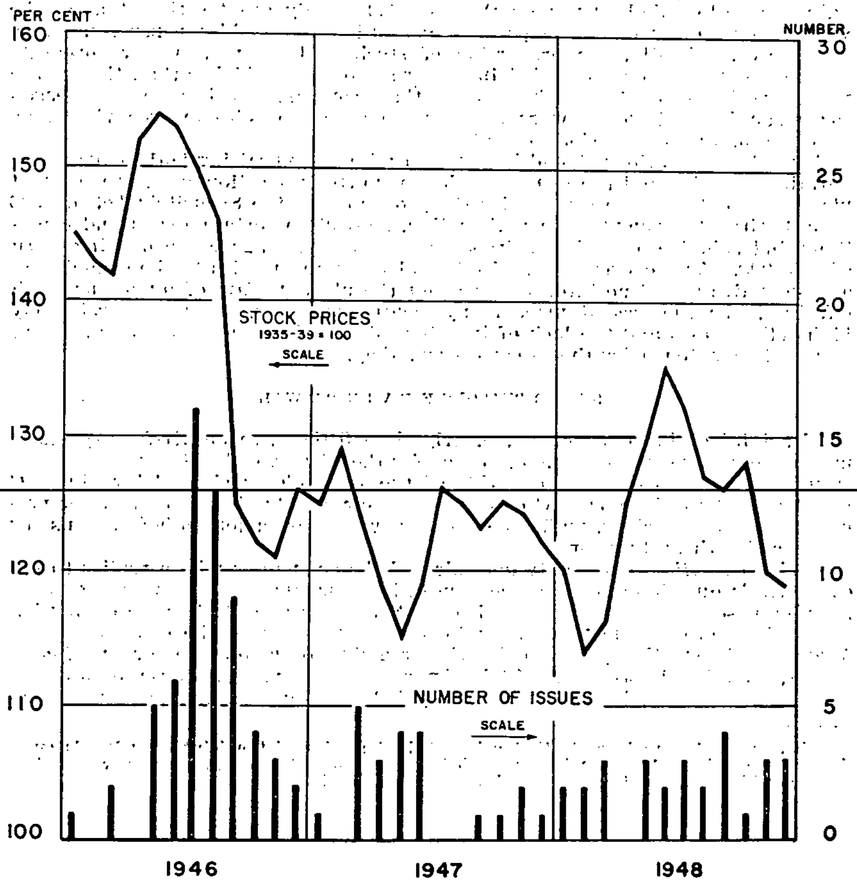
7. Study of the replies of the committee's questionnaire and of other materials relating to the availability of equity capital suggests that the problem is more

fundamental in character than just a matter of market conditions, even though that was the reason most respondents gave for withdrawing their registration statements. There are some companies—particularly smaller ones whose products and achievements are virtually unknown to the majority of investors—that have no ready market for their securities, except possibly in periods of extreme investor optimism. In addition, skepticism of individual investors about merits of equity-share ownership impede external equity-capital financing even by some large, well-established companies in the postwar period.

The types of concerns that are unable generally to sell their equities to individual investors vary greatly in character from extremely speculative, untested promotions to established businesses with sharply fluctuating earnings records. It should be recognized that many business promotions—from the point of view of the general economy as well as the individual investor—never warrant outside equity funds either because they are completely impractical and unfeasible, or because they have too small a chance for success.

The lack of interest of individual investors in enterprises with fluctuating earnings, even if the concern is well established, is understandable unless the investor has a large income and accumulated savings and can risk possible heavy losses. If it is desirable from the point of view of the general economy, for such enterprises and for untested promotions with a reasonable chance of success to obtain equity capital through stock sales, new sources of such capital should be explored.

NUMBER OF SECURITY ISSUES SUBSEQUENTLY WITHDRAWN, BY MONTH OF REGISTRATION, COMPARED WITH COMMON STOCK PRICES



COMPARATIVE REGISTRATION AND WITHDRAWAL EXPERIENCE

Securities and Exchange Commission reports covering the fiscal period July 1, 1945, to June 30, 1948, reveal that a total of 1,768 proposed bond and stock offerings were registered, of which 216 were subseqently withdrawn by the registrants. The proportion of withdrawn to total registrations (12.2 percent) for the postwar fiscal period 1945–48 was only slightly higher than that of the war period (11.9 percent) and was well below the prewar average of 15.7 percent, as is shown in the following table:

Registration statements filed and withdrawn, 1933–48

Period	Number of registration statements		
	Filed	Withdrawn	Withdrawn as percentage of filed
July 1, 1945, to June 30, 1948	1,768	216	12.2
July 1, 1941, to June 30, 1945	1,030	123	11.9
June 1933 to June 30, 1941	4,790	754	15.7
Total	7,588	1,093	14.4

NOTE.—Registrations cover both bond and stock issues.
Source: Annual Reports of the Securities and Exchange Commission.

Moreover, the postwar volume of corporate security issues for new money (averaging 3.8 billion dollars per year) was substantially greater than that of the wartime or prewar (1933–41) periods (0.6 billion and 0.7 billion per annum, respectively). Finally, the proportion of stock to total new money corporate security issues during the period 1946–48 was somewhat higher than that of the prewar period 1933–41. On the basis of these comparisons there is little reason for concluding that the postwar withdrawal experience has been more unfavorable than that of any other period since 1933.

Several qualifications should be borne in mind in appraising both comparative withdrawal rates and the results of the committee's questionnaire. In the first place the SEC is empowered under the provisions of the Securiteis Act of 1933 (sec. 3 (b)) to exempt from registration, subject to certain terms and conditions, individual issues of securities not exceeding an aggregate offering price of $300,000. As a consequence, withdrawal rates and replies to the committee's questionnaire afford no information about the ultimate fate of numerous small offerings. In the second place many small businesses, because of relatively high selling costs and the lack of investor interest, have not made any attempt in recent years to market their securities publicly.

STATED REASONS FOR WITHDRAWAL

Of a total of 125 respondents,[8] nearly three-fifths gave unsatisfactory stock-market conditions as the primary reason for the withdrawal of their registration statements. Approximately one-fifth of the respondents cited delays in SEC registration procedure or SEC objection to their registration statements or proposed security offerings, while the remainder offered various other reasons for withdrawing their statements.

Market conditions.—Roughly one-third of the companies whose replies to the committee's questionnaire have been used in preparing this analysis registered their proposed security offerings with the Securities and Exchange Commission during the period June to October 1946. As is shown in the chart July and August 1946 were the months of heaviest registration among this group of companies, 16 filing in July and 13 in August. Stock prices, as represented by Standard & Poor's index of approximately 400 common stocks, reached a postwar

[8] There were 182 registrants that acknowledged receipt of the joint committee's questionnaire; of these, 10 had withdrawn their registration statements for purely technical reasons, while 47 failed to supply the information desired.

peak of 154 in April 1946; thereafter they declined gradually through August, broke sharply in September, and reached a temporary low of 121 in November 1946.

Among those respondents who cited security market conditions as the primary reason for their subsequent withdrawal of registration statements, there were some that discussed the problem in detail or gave specific data on the price declines of their stocks, as illustrated by the following quotations:

"The registration statement for the 1,647,037 shares of common stock of the corporation was withdrawn as a result of the sharp break in the stock market in early September 1946. This break, affecting all stocks, was of such proportions that the corporation would not have been able to obtain a price for its common stock which it considered fair, in the light of the common stock's book value and the corporation's position. This break occurred just before the warrants offering the common stock to the corporation's stockholders were to be mailed out. The offering was first postponed and then ultimately withdrawn when stock-market conditions did not improve.

* * * * * * *

"Between the date of the filing of the registration statement and the date on which it was proposed to make a public offering of the 25,000 cumulative preferred shares, there occurred a very sharp break in the securities market and the underwriters advised the company that they would be unable to sell the securities of the company even though the dividend rate were to be increased above that which had been initially contemplated.

* * * * * * *

"Since the proposed financing was a convertible preferred stock and since the market value of the common stock had declined substantially while the issue was in preparation, in order to market the issue it would have been necessary to set a lower conversion price than originally expected. This would have resulted, in the opinion of the management, in too great a dilution of the equity of the common-stock holders.

* * * * * * *

"At time the application was filed the market price of the shares to be sold was about $14 per share. In keeping with the general market trend said shares had dropped to $11.50 per share, which price the company was not willing to accept for its securities, therefore, the S–1 application was withdrawn.

* * * * * * *

"Between March and November 1946 when the company was endeavoring to comply with SEC requirements, the market price of shares in the company fell off from over $4 to $2.25 per share. The directors did not deem it advisable to market shares at the lower prices then prevailing."

Much more numerous, however, were replies like the following:

"Current unfavorable market conditions."

While it appears that many proposed security offerings were registered during months of marked stock price declines, it should be remembered that the decisions by corporate stockholders and management to proceed with the contemplated financing were made well in advance of actual registration dates and at a time when the trend of security prices was favorable. On the whole, it seems fairly evident that pronounced market fluctuations during the spring and summer of 1946, the spring of 1947, and the summer of 1948 were major factors prompting or necessitating postponement of offerings and subsequent withdrawals of registration statements during the period 1946–48.

The above observation is further confirmed by computation of the decline in the price of common stock of each registrant for which price data could be obtained from a date on or near the time the registration statement was filed to a date about 60 days later. The median price decline of the common stocks of these individual respondents was 12 percent—considerably more of a decline than that represented by day-to-day fluctuations in the general level of stock prices.

It cannot be determined, from the answers to the committee's questionnaire, how many registrants actually attempted to sell their securities and then withdrew the offering because of unfavorable market reception. There are indications, however, that a number of proposed offerings were withdrawn prior to actual sale, whether on the advice of underwriters, on refusal of the underwriters to proceed, or on the registrants' own initiative.

Neitner the general condition of the security market during and after the time registration statements were filed by these companies nor the underwriting agreements covering the proposed security offerings were conducive to confidence in the success of their attempted sales. A total of 56 companies, representing less than half of the replies analyzed, had negotiated firm underwriting commitments with their prospective underwriters, and even these agreements were generally contingent upon the existence of a satisfactory securities market and permitted the underwriter to withdraw from the contract in the event of adverse market developments.

Information concerning the nature of the underwriting agreement, if any, was not furnished by 10 of the 125 respondents, while 36 reported underwriting commitments on a "best efforts" basis; 10 had no underwriting commitment, and 13 had other arrangements covering the sale or exchange of their securities. In the case of "best effort" underwriting commitments the company offering the security has no assurance as to the proceeds that will be realized from its sale. Rather than accept whatever might be offered for their securities in a generally declining stock market, these companies preferred to withdraw their stock offerings.

Procedures and requirements of SEC.—Approximately one-fifth of the 125 respondents submitting analyzable replies attributed withdrawal of the registration statements to delay and complexity of SEC registration procedures or to SEC objection to their proposed security offerings. Of those that did, a large number were Canadian mining companies of a speculative or promotional character.

In an effort to evaluate the criticism of registrants that objected to SEC requirements, SEC staff members reviewed each of the cases involved and summarized their findings. The majority of registrants who withdrew their registration statements because of SEC objection criticized the delays and complexities involved in the registration procedures, but SEC files revealed that the registration statements contained material misstatements or omitted facts, and that the registrants themselves more often than not delayed consideration of their cases by failing to supply promptly the information requested. The following comments taken from a registrant's reply to the committee's questionnaire and a memorandum of an SEC staff member illustrate the difference of opinion between registrants and the Commission:

Registrant's statement

"The SEC requested additional information and gave us a time limit of 30 days. It was physically impossible to acquire, compile, and file the requested information in a time less than 6 months."

SEC statement

"The registration statement was apparently prepared without proper consideration of the requirements of the Securities Act and was materially incomplete, inaccurate, and misleading."

In sum, relatively few registrants criticized SEC procedures and requirements, and many of these were speculative enterprises. Moreover, the criticism was usually expressed in such general terms that it was not possible to discover in what specific way the SEC could amend its procedures or requirements in order to meet such criticism. SEC staff comments on the cases were also quite general, their sum and substance being that the SEC asked only for financial and other information that it considered necessary for adequate investor evaluation of a company's financial position and earnings prospects.

EFFECTS OF FAILURE TO MARKET SECURITIES

The real significance of a company's failure to market its security issues can only be determined on the basis of the company's need for funds and the availability or lack of alternative sources of financing. A company that requires additional equity capital for expansion of its productive facilities or financing current operations and is unable to obtain the funds from alternative sources is in a very different situation from that of a company seeking to refund a high-dividend preferred stock with a lower yield security or a company that has ready access to alternative financing. These contrasting situations may be illustrated by two cases selected from the replies to the committee's questionnaire.

In the case of company A, approximately $5,000,000 was required to redeem outstanding bonds and preferred stock, amounting to slightly more than $3,000,000, and to increase working capital by roughly $2,000,000. Original financing plans called for the sale of $4,000,000 worth of bonds and $1,000,000 of preferred stock. Because of prevailing market conditions, the proposed sale of preferred stock was abandoned; however, the company successfully marketed its $4,000,000 bond issue. Proceeds of the bond issue, together with $500,000 obtained from short-term bank loans and $100,000 of retained earnings provided a total of $4,600,000 of which $2,600,000 was used to refund the prior outstanding bonds and $2,000,000 was added to working capital. While this company did not realize its objective of retiring its outstanding preferred stock, its current operating program was not seriously hampered by inability to obtain working capital, and it could afford to wait for an improvement in the general security market situation to refinance its preferred stock. It did, however, incur certain costs in preparing and filing a registration statement that was not used and it was also obliged to continue its heavier burden of dividend and interest charges, which may or may not have been an appropriate additional burden in view of prospects for expansion of operations.

In the case of company B, on the other hand, total funds of $875,000 were sought through the sale of common and preferred stock, the proceeds to be used as follows: To pay off short-term notes of $170,000 and a chattel mortgage of $285,000; to purchase additional machinery and equipment costing $90,000; and to add the remaining proceeds (approximately $330,000) to working-capital funds. The SEC questioned the propriety of writing up the value of the registrant's physical assets in view of operating losses suffered by the company in every year from 1929 to 1946. As a result, the registration statement was withdrawn. Subsequently, a new chattel mortgage for $325,100 was negotiated, the proceeds being used to pay off the prior mortgage and short-term notes. Additional working-capital and expansion funds were not obtained, however, and in the respondent's own words, "The failure to obtain the qualification of the referenced issue completely curtailed and made impossible of effectuating the program of plant rehabilitation and seriously handicapped the company's production possibilities. Because of the dearth of working capital, the production of the plant is only one-third of its capacity."

Reasons for proposed equity financing

The discussion thus far has been based on total withdrawals, both bond and stock issues for refinancing and new money, and secondary as well as primary distributions. Of the 125 total withdrawals, 13 were bond issues, 14 were secondary stock issues of major stockholders seeking investment of all or a part of their holdings, 9 were stock issues for refinancing purposes, and 89 were stock issues to provide new money for additional fixed or working capital.

Of these 89 issues, approximately one-half of the 89 proposed new-money stock issues were single purpose (working capital or plant expansion), while the other half were multiple purpose (working capital, plant expansion and/or debt repayment). In both cases funds were sought for the purpose of financing growth, modernization, and more flexible operating conditions, and in the majority of instances it may be assumed that the additional funds were essential from the management's viewpoint to the continued economic well-being of the enterprise. On the other hand, the immediate operations or expansion plans of those 23 registrants whose proposed security offerings covered refinancing of outstanding securities, or changes in capital structure and in stockholdings were not dependent upon the success of the offering. In the majority of cases the latter registrants could afford to await development of market conditions more favorable to the sale of their securities, especially as there was little, if any, evidence that these registrants were under any sort of pressure from creditors to repay or refund their existing indebtedness.

Banks and insurance companies a major source of alternative financing

The 89 companies that registered proposed common or preferred stock offerings for the purpose of obtaining funds to satisfy operating or expansion needs and subsequently withdrew their registrations, had varying degrees of success in obtaining funds from alternative sources. As is shown in the table, one-third succeeded in financing their requirements in full either by subsequent sale of equity securities or from alternative sources, somewhat less than one-third were partially successful in alternative financing, while the remainder did not cover any part of their needs.

Experience of companies that withdrew registration statements in financing their requirements from alternative sources[1]

Wholly successful in obtaining funds from:	
Insurance company loans	9
Bank loans	6
Stock sales	3
Bond sales	2
Other, including combination of the above and retained earnings	8
Total	28
Partially successful in obtaining funds from:	
Bank loans	6
Stock sales	5
Bond sales	2
Insurance company loans	2
Other, including combination of the above and retained earnings	11
Total	26
Unsuccessful in obtaining funds	35
Total	89

[1] Companies seeking equity capital on their own behalf to finance expansion of plant and/or working capital; excludes those registering proposed stock offerings on behalf of major stockholders or for the purpose of refunding outstanding bond or stock issues.

Of the unsuccessful applicants for equity capital who financed their requirements in full from alternative sources, more than one-half resorted to debt financing in the form of bank or insurance company loans. In several instances the needed funds were supplied out of retained earnings, and in a number of cases more than one source of funds was utilized. Except for four comments to the effect that alternative financing employed was less desirable because it involved debt rather than equity capital, the question "what were the consequences of your failure to raise funds" elicited no response among this group of applicants.

Half of the registrants who were only partially successful in financing their requirements from alternative sources indicated that curtailment of plant expansion and improvement was the principal consequence of the failure of their original financing plans. The experiences of the other half were varied; some companies implied by their failure to answer the question that the consequences were relatively minor, while others mentioned tight working capital positions, necessity of resorting to RFC financing, and other consequences. Bank loans and retained earnings were most generally relied upon by this group of registrants in meeting their more pressing needs for additional funds, though five respondents reported partial success with subsequent sales of their stock.

With the exception of three respondents that were forced into bankruptcy or to discontinue operations, the primary consequences of failure to market securities as originally planned or to obtain funds from any other source were curtailment of expansion plans or financial embarrassment resulting from inadequate working capital.

Small companies encounter greater financing difficulties

Insofar as it is possible to generalize from the varied and in some cases conflicting experiences revealed by the answers to the committee's questionnaire, smaller companies encountered more difficulty both in selling their securities and in obtaining funds from alternative sources than was the case for the larger and better known enterprises. Of the respondents who withdrew their registration statements but subsequently obtained all of the required funds from other sources, the majority had total assets between 10 and 50 million dollars, five had total assets in excess of $50,000,000, and none had total assets of less than $1,000,000. On the other hand, only one of the registrants that failed to obtain funds from any source had assets in excess of $50,000,000, while there were five with assets of less than $1,000,000. However, it does not follow that all small companies are unable to finance their requirements from security sales or from some alternative source, such as a life-insurance company loan. There were seven registrants, each with total assets of less than $5,000,000, that succeeded in obtaining all the funds they required, and eight that were partially successful in such alternative financing.

Other financing since 1945

The withdrawal of one registration statement is not prima facie evidence of chronic inability to obtain long-term borrowed or equity capital. Since 1945 roughly one-fourth of the respondents were wholly or partially successful in selling stocks and/or bonds at times other than that when their registration statement was withdrawn. In fact, there were several companies that successfully marketed two or three different security issues during this period, which indicates that the withdrawal in question was prompted by temporary market conditions rather than a chronic inability to sell their securities. On the other hand, three-fourths of the respondents have not sold any bonds or stocks publicly since 1945, while a few obtained temporary financing at other times in the form of bank and insurance company loans.

SUGGESTIONS FOR FACILITATING EQUITY CAPITAL FINANCING

Slightly less than one-half of the respondents offered specific suggestions for enhancing the ability of business concerns to obtain equity financing. Of this group the majority suggested more liberal structure and reduced rates of Federal income taxes, while one-fifth advocated revision of SEC requirements to simplify and expedite the filing and clearance of registration statements, and the remainder offered miscellaneous suggestions, ranging from greater assumption of responsibility on the part of underwriters to less Government interference in business activities. Some of the respondents replied at length to the question, but the majority summarized their views in one or two sentences.

Revision of Federal income tax structure and rates

The majority of respondents who singled out the present structure and rates of Federal income tax as the principal deterrent to equity capital investment attacked what they termed the double taxation of corporate earnings. They maintained that taxation of corporate earnings at the source and again in the form of personal income taxes on corporate dividend payments was stifling the incentive for individuals to invest their savings in equity capital shares. Generally speaking, the respondents who discussed double taxation of corporate earnings felt that the structure of Federal income taxes should be revised to exempt a larger portion of dividend income from taxation, and that income-tax rates in general should be reduced as much as possible. Typical of these views are the following:

"The * * * corporation feels very definitely that incentives must be provided for investors to encourage risk financing through the sale of common stock. This is true both for big and little business. The experience of the corporation and many other corporations has shown that present conditions are such as to deter equity financing which we believe to be essential for a continued industrial progress in this country, for business of all sizes * * *. It is the opinion of the officers of the corporation that incentives to investment in equities could best be provided through modification of the tax laws, essentially in two respects: (1) Eliminate the double taxation of corporate income which passes to stockholders by eliminating the tax on dividends received by stockholders, and (2) limit the maximum rate of tax to 50 percent of income, corporate or individual."

* * * * * * *

"First of all, the tax percentage rise on corporate earnings would increase investor interests if an allowance within the same brackets for the tax were allowed to the receiver of dividends. Secondly, if the wartime regulation applicable to war plant investments regarding a speed-up provision in depreciation were permitted, capital expansion could be greatly increased and encouraged. This should only be applicable against new capital expenditures, since the depreciation could be then deducted from foreseeable profits in the near future instead of held as a threat against long and advanced profit and loss statements and analyses of the future * * *."

* * * * * * *

"We believe something must be done to entice abnormally large amounts of private venture capital into the field of purchasing stocks instead of the present subnormal amount. To attract such capital small companies like ours must be able to pay higher dividends and to accomplish this we must have profits. We have two suggestions that would greatly help companies in our position."

"(1) A realistic depreciation allowance to overcome our present difficulty of depreciating equipment on the basis of less than half its replacement value.

"(2) Exemption from income tax on a certain amount of profit paid out as dividends.

"We feel that it would also aid the situation to allow stockholders exemption from income tax on a small amount of dividends, for example $2,500 per year."

Revision of SEC registration requirements and procedures

There were, in all, some 16 promotional and speculative mining and other ventures which found their proposed security offerings blocked by their inability or unwillingness to comply with provisions of the Securities Act of 1933. In addition, there were eight established companies whose activities would not be classed as speculative or promotional in character that suggested changes in SEC registration procedure to simplify requirements and expedite approval. Unfortunately, as illustrated by the following quotations, most of the suggestions are too abbreviated and generalized to throw much light on the particular problems involved:

"The time involved in completing registration with SEC does not permit the issuance of securities under favorable marketing conditions which are not of long duration."

"Less insistence by SEC upon compliance with requirements that appear to merely embarrass and delay applicants without providing real assistance or protection to an investor."

A few of the comments relating to SEC requirements were more specific, as evidenced by the following quotations:

"We think a sincere, studied effort should be made to streamline the procedure or requirements of the SEC. For example, once a company has registered with the SEC and thus has supplied all relevant information concerning status and operations and which, as a further result is required to file complete annual reports with the Commission, thus for all practical and necessary purposes, the general public is constantly informed as to the company's position. Such a company should be able to qualify new securities for sale with a minimum of additional reports to the Commission, said reports involving primarily information concerning material changes in its position only. This would cut down the time required to qualify new securities for sale which time lag presently constitutes a stumbling block and a hazard because of the natural fluctuations of the market during such interim."

Miscellaneous comments and suggestions

A number of respondents merely suggested that something should be done to encourage the flow of venture capital and reawaken investor interest in securities that contain some element of risk, but offered no concrete suggestions as to how this might be accomplished. A few respondents overlooked the fact that the flow of equity capital investment reached unparalleled levels in recent years, as illustrated by the following comments:

"Adequate financing of private enterprise is dependent on investor confidence in the general economic outlook. Such confidence appears to have been shaken in the past several years by the heavy spending policies of the Government; and continued excessive income taxes both drain off funds which might normally go into investment and discourage risk-taking capital enterprises because of the small rewards possible after such high taxes."

* * * * * * *

"There are very few companies, big or small, that are in as good a relative financial position as we are. We have a consistent earning record over the past 10 years. We have paid very conservative dividends. The bulk of our money has been invested in new equipment and some expansion. The family would like to liquidate about one-third of their holdings. Both brokers told us it could not be done. When a big corporation, doing lots of national advertising and selling a product which is known to the consumer public, desires additional working capital to offset losses or for expansion, they have very little difficulty in obtaining it. Witnesseth: the Tucker Corporation. Speculative or otherwise, the public will go for something which has a big build-up and which appeals to their imagination. Because of this, small corporations must pay out less in dividends and conserve more of their earnings, for they cannot in 90 days jump into the stock market and obtain working capital or additional capital for expansion purposes as can the larger company. * * * If additional capital could be readily obtained by a company of this kind we would be more liberal with our dividend payments. That should be of some interest to some people who believe that dividends are not being paid out by small corporations in sufficient amount."

One respondent specially mentioned an obstacle to equity capital financing that was implied but not discussed in several other replies, viz, the reluctance of underwriters to assume sufficient responsibility for marketing a proposed security issue:

"Reason advanced by underwriters for cancellation is too flimsy. An undertaking such as ours required a great deal of effort and expense and long-time planning. There should be substantial guarantees by underwriters. The 'state of the market' is a temporary condition and should not be permitted to upset plans covering many years."

Appendix A

DESCRIPTION OF QUESTIONNAIRE AND RESPONDENTS

To supplement the information contained in the SEC tabulation of registrants who filed and subsequently withdrew their registration statements during the period 1946–48, a mail questionnaire was employed. (See appendix B for letter of transmittal and questionnaire.) This questionnaire was prepared by staff members of the joint committee, in consultation with staff representatives of the Securities and Exchange Commission and the Board of Governors of the Federal Reserve System.

Objectives

The primary objectives of the joint committee's questionnaire may be summarized as follows:

1. To ascertain the primary reason or reasons for withdrawal of registration statements.
2. To relate availability of alternative financing to the needs that prompted the original intention to market securities publicly, and to assess the consequences of failure to obtain equity capital or other financing.
3. To determine whether the experience of registration and withdrawal was indicative of a chronic inability to obtain such financing on the part of individual companies, or a temporary situation related to the condition of the security market at the particular time chosen for sale of the security.
4. To obtain from concerns that had experienced difficulty in equity capital financing first-hand suggestions and recommendations as to what might be done to facilitate the distribution and sale of such securities.

Response

Of the 232 registrants circularized, 182 acknowledged receipt of the committee's communication, either by filling in the questionnaire, by letter giving some or all of the information requested, or by indicating that the information was not available or that the questionnaire was not applicable to the particular circumstances of the individual respondent's case. With very few exceptions, the respondents expressed or implied a willingness to cooperate with the committee, and in some cases the questions were answered in considerable detail. Out of 182 acknowledgements to the committee's questionnaire, 125 replies were selected for analysis; the remainder, as shown by the following tabulation, were omitted either because the information was not supplied or the withdrawals of registrations were necessitated by conditions entirely unrelated to the securities market or SEC registration requirements and procedure.

Response to joint committee questionnaire

Number of registrants queried		232
Number of registrants responding		182
Eliminations:		
Technical withdrawals	10	
Replies containing little or no information	47	
		57
Usable replies, representing:		
Established business enterprises seeking:		
New equity capital for their own use	89	
Equity capital for refunding or refinancing and all debt issues	22	
Stockholders seeking to divest themselves of major holdings	14	
		125

Characteristics of respondents selected for analysis

Six of the registrants, as shown in the table, are large, nationally known concerns with total assets of $100,000,000 and over. The sound financial position, established record of earnings and dividends, and wide distribution of stock ownership of these large companies would normally assure a ready market for any new money or refunding security issues that they might offer. In contrast to these large companies are the 20 small manufacturing and trade concerns with total assets of less than $1,000,000—many of which are owned by relatively few stockholders—with whose products and financial experience the investing pubic is by and large unacquainted. The latter companies might well experience difficulty in any public marketing of their securities, despite a satisfactory financial position and favorable earnings/dividend prospects, for the simple reason that the investing public knowns little or nothing of them.

Between these two extremes of size and distribution of ownership lie the majority of companies that filed and subsequently withdrew registration statements during the period 1946–48. Some are financially sound enterprises with good earnings and dividends records whose products and investment prospects are well known. Others may be widely known as fair-to-marginal investment prospects, and some undoubtedly—while offering excellent investment prospects—are virtually unknown to the investing public. These differences in public acceptance are mentioned primarily to emphasize the fact that changes in security market conditions, the reason cited by the majority of respondents for withdrawal of their registration statements, do not have the same connotations for all companies. Some concerns have virtually no widespread market for their securities, regardless of the prevailing trend and level of security prices, while other concerns with well-established markets for their securities are nevertheless dependent upon the general tenor of the market for realization of what they consider to be a fair or reasonable price for their security offerings.

Roughly, two-thirds of the respondents who registered and subsequently withdrew their registration statements are manufacturing and mining concerns. As is shown in the table, approximately half are evenly distributed among various categories of nondurable goods manufacture; the other half are manufacturers of durable goods, with metals and metal products and machinery predominating. Among the nonmanufacturing industries, the largest representation is in trade and electric and gas utilities. All in all, the industrial representation is sufficiently varied to indicate that the difficulties encountered by these registrants in marketing their securities are not attributable to the economic position or outlook of any particular industry.

Industry/size classification of companies that subsequently withdrew SEC registration statements [1]

Industry	Total	Total assets (in millions of dollars)								
		Less than ½	½ to 1	1 to 5	5 to 10	10 to 25	25 to 50	50 to 100	100 and over	Not available
Manufacturing:										
Machinery, including electrical	17	1	1	11	1	1	0	1	1	0
Transportation equipment, including automobiles	8	1	1	2	0	3	0	1	0	0
Metals	7	0	1	2	2	1	0	0	0	1
Textiles and apparel	10	0	1	2	2	2	2	1	0	0
Petroleum, chemicals and rubber	10	1	2	1	1	2	1	1	0	1
Food and beverages	8	0	0	2	0	3	1	1	1	0
Other manufacturing	17	1	2	4	5	3	0	0	0	2
Mining	9	6	0	1	0	1	0	0	0	1
Trade:										
Wholesale	2	0	0	2	0	0	0	0	0	0
Retail	7	0	0	1	1	3	0	1	0	1
Utilities:										
Electric and gas	7	0	0	0	0	0	1	3	3	0
Transportation	4	0	0	1	0	2	1	0	0	0
Communication	5	0	0	0	0	3	1	0	1	0
Service	3	1	0	1	1	0	0	0	0	0
Financial	9	1	0	2	0	2	1	1	0	2
Other	2	0	0	0	0	0	0	0	0	2
All industries	125	12	8	32	13	26	8	10	6	10

[1] Companies that submitted analyzable replies to the joint committee's questionnaire, excluding those that withdrew their registration statements for technical reasons. End-of-year 1947 total assets were used wherever available, but for some companies no data more recent than 1945 or 1946 could be obtained.

APPENDIX B

LETTER OF TRANSMITTAL AND QUESTIONNAIRE

JULY 22, 1949.

DEAR SIR: By direction of Congress, the Joint Committee on the Economic Report has undertaken a survey of investment. The subcommittee appointed to conduct this study has obtained the cooperation of the Federal Reserve Board in connection with which it is now making inquiry into the financing of business.

The general purpose of the study is to gain information as to capital requirements of business for plant expansion, replacement or working capital, and the conditions which promote or impede the investment of private capital in business or industry on either the local or national plane. As a part of that study, an inquiry is being made of the recent financing experience of individual businesses with a view to analyzing the various factors which play a part in the program and timing of new financing, such as requirements for investment funds, general business outlook, market conditions, reinvested earnings, and similar matters.

Your corporation has been selected as a possible source of information on this general subject because of your postwar experience. During that period, your financing plans had developed to a point where a public offering of securities was contemplated and a registration statement was filed with the Securities and Exchange Commission. Subsequently, these plans were changed and the registration statement was withdrawn. While you have given the Securities and Exchange Commission general reasons for the withdrawal, we feel it would be most helpful to us if we could obtain a more detailed explanation of the considerations which prompted this action.

This committee would appreciate your cooperation in filling out the attached questionnaire and returning it in the enclosed envelope to this office before August 2, if possible. The committee needs this information to achieve a better understanding of the experiences of business in obtaining capital required for investment purposes under current economic conditions.

It would be extremely valuable to the committee if, in addition to answering the enclosed questions, you will undertake a discussion of the general problems of investment as you see them.

Very truly yours,

JOSEPH C. O'MAHONEY, *Chairman.*

JULY 1949.

Joint Committee on the Economic Report (created pursuant to sec. 5 (a) of Public Law 304, 79th Cong.)

QUESTIONNAIRE ON WITHDRAWAL OF S. E. C. REGISTRATION STATEMENT

Name of corporation____

Nature of business______________________ Number of stockholders_________

1. Description of contemplated security issue:
   (*a*) Type of security____
   (*b*) Size of issue____
   (*c*) Purpose of issue_______________________________________
   (*d*) Nature of underwriting (check one and describe if "Other"):
   (1) Firm □. (2) Best efforts □. (3) Other____________________
   (*e*) Date issue authorized by board of directors_________________
   (*f*) Date registration statement filed___________________________
   (*g*) Date registration statement withdrawn______________________
2. Why was the registration statement withdrawn? (Please discuss reasons as fully as possible. Use separate sheet if needed for full answer)________
3. Were the funds subsequently obtained from other sources? If so, describe (e. g., retained earnings, bank or insurance company loan, and so forth.)____
4. If not, what were the consequences of your failure to raise the funds? (e. g., curtailment of expansion plans, and so forth.)______________________
5. What other financing has the company undertaken since 1945, and for what purpose?____
6. In the light of your experience in not being able to finance at the time and as originally planned, what concrete suggestions do you have which, if adopted, would have enhanced your ability to finance?______________________

The CHAIRMAN. Tomorrow morning at 10 o'clock the witness will be Mr. Edward Hopkinson, Jr., of Drexel & Co. Then in the afternoon Mr. Winthrop Smith of Merrill Lynch, Pierce, Fenner & Bean will be the principal witness, but we have some additional dramatis personae tomorrow, do we not?

Mr. SCOLL. We will have the representative back here from the insurance companies and also Dr. Kaplan will be here to consider the aspects of the hearing that have developed concerning availability of capital to intermediate business and small business, probably a round-table discussion.

The CHAIRMAN. The committee will stand in recess until tomorrow at 10.

(Whereupon, at 3:30 p. m., the committee adjourned, to reconvene at 10 a. m., Friday, December 16, 1949.)

VOLUME AND STABILITY OF PRIVATE INVESTMENT

FRIDAY, DECEMBER 16, 1949

Congress of the United States,
Joint Committee on the Economic Report,
Subcommittee on Investment,
Washington, D. C.

The subcommittee met, pursuant to adjournment, at 10:30 a. m., in the caucus room, Senate Office Building, Senator Joseph C. O'Mahoney (chairman) presiding.

Present: Senator O'Mahoney and Representative Herter.

Also present: David Scoll, special counsel to the committee, and Theodore J. Kreps, director of staff.

The Chairman. The committee will come to order.

Mr. Hopkinson, will you come forward? Be seated, please.

I felt it might be desirable to make a few preliminary remarks, because we are coming toward the close of these hearings.

The testimony, including various statistics placed in the record by the witnesses who have appeared before the committee, indicates that, generally speaking, capital formation and the flow of savings into private investment are continuing at fairly high levels. The figures presented to the committee and assembled by the staff indicate that for the time being, at least, new investment continues at a fairly lively rate. Several of the witnesses, men experienced and influential in the capital markets, have expressed optimistic opinions of our domestic economy as a whole and of the outlook.

The huge total of insurance company investment in industrial debentures, in obligations depend wholly upon the earning capacity of the corporations issuing the securities, seems to indicate a very optimistic view of the prospects of business for a considerable period in the future.

Particularly significant, it seems, is that the flow of investment goes into big business rather than into small and intermediate business. The ~~subcommittee in the preparation of its report will have to give serious~~ consideration to each of these problems, especially, the advantage that big business, mature business, has over small and intermediate business in having access both to debt capital and to equity capital.

This problem of opening the channels of investment to small and intermediate business is one which to my mind has not been given the attention it deserves, either by the insurance companies or by the investment bankers. We have, therefore, requested representatives of the life-insurance companies who appeared before us earlier, and Mr. Winthrop Smith, of Merrill, Lynch, Pierce, Fenner & Beane, Mr. Edward Hopkinson, Jr., of Drexel & Co., as well as Dr. A. D. H. Kaplan, of the Brookings Institution, to participate with the members of the

Subcommittee on Investment and the staff in a round-table discussion of the financing of small and intermediate business this afternoon at 2 o'clock in this room.

These are some of the points on which I would like to obtain opinions at this afternoon's meeting:

(1) Is it possible for small and intermediate business to obtain its capital requirements through existing channels, having in mind that—

(*a*) the current high yield on seasoned common stocks make it difficult to float small common-stock issues at reasonable cost;

(*b*) credit requirements for long-term loans by life-insurance companies limit life-insurance investment to established companies, regardless of size, with stable earning records and favorable debt-equity ratios; and

(*c*) institutional investors and investment trust companies are similarly limited as to the types of investments which they can make?

(2) If additional financial facilities should be provided for small and intermediate business, should the Federal Government expand its activities in this field by providing facilities for business-loan insurance as suggested by the Small Business Advisory Committee of the Department of Commerce?

(3) Dr. A. D. H. Kaplan suggested a capital bank plan to this Committee whereby regional banks would be established within the Federal Reserve System, under policies laid down by Congress and administered by the Federal Reserve Board. Such banks would be permitted to purchase capital stock as well as the debt paper of an enterprise. The bank would furnish business advisory services as well as capital financing, working through the facilities of the local commercial banks in helping individual enterprises through their financial vicissitudes. Commercal banks in each Federal Reserve district would be permitted to subscribe a small percentage—up to 3 percent—of their capital and surplus in the regional bank. Under an extension of the plan, the capital bank would be permitted to place its debentures or rediscount its paper with the Federal Reserve bank. As stated by Dr. Kaplan:

> Capital bank financing for small business would require a varied base. It could be supported by collateral, securities, accounts receivable, or certificates of indebtedness, secured or unsecured as the conditions warrant. Such a bank should be permitted to purchase capital stock as well as the debt paper of an enterprise. But it should have regard for the objectives of fostering independent ownership by the small enterpriser. To this end, preferred stocks should be made callable by the issuing firm on a prearranged program. In taking the common stock of a borrower, the bank, as stockholder, should be permitted to share in the earnings and in the increase of equity values; but there should also be provision for redemption of capital stock by the issuing firm within agreed time limits and adjustments of the transfer value of the stock so that the management of the small enterprise may regain its full control of the venture.

Should the Joint Committee on the Economic Report recommend legislation to establish such capital banks?

(4) Should life-insurance companies be permitted to invest a small portion of their surplus in such a capital bank?

(5) Would it be desirable to permit investment trust companies to invest a portion of their funds in such a capital bank?

(6) Would it be desirable to permit the capital banks themselves to invest in such enterprises as American Research & Development

Corp., which specialize in the financing of new enterprises of special technological value?

We would be very glad to have you proceed.

STATEMENT OF EDWARD HOPKINSON, JR., DREXEL & CO., PHILADELPHIA, PA.

Mr. HOPKINSON. My name is Edward Hopkinson, Jr. I live in Chestnut Hill, Philadelphia. I am a partner in the firm of Drexel & Co., whose main office is in Philadelphia, with a branch office in New York.

The present firm of Drexel & Co. was organized in 1940. We are a relatively small firm. We conduct an underwriting business and engage in the purchase and sale of securities both on the stock exchanges and in the over-the-counter markets. We also act as financial advisers to a number of corporations and individuals.

My own experience was in the practice of law from 1910 to 1926; then as a partner of Drexel & Co.—J. P. Morgan & Co. until 1940, when the latter firm incorporated as a New York bank and trust company. That was the occasion for me and some of my Philadelphia associates to organize the present firm.

As a director of a number of business and financial corporations, I have had close contact with the securities markets in that capacity, as well as an investment banker.

I have recently served as president of the Investment Bankers Association of America, as chairman of the executive committee of the Philadelphia Chamber of Commerce, and am presently a member of President Truman's Advisory Committee on Financing Foreign Trade, and a vice president of the Pennsylvania State Chamber of Commerce.

I am very glad to comply with the request of the Subcommittee on Investment to appear here today and discuss some of the topics suggested for investment bankers.

Your committee is rightly concerned with the problem of raising the capital funds, which are the lifeblood of industry, to improve productivity, and it is only by improving productivity that our standard of living can be raised over any extended period of time. For the excess cash required for capital expenditures, a corporation has the alternative of going to the public for new funds, or retaining earnings after taxes. In the years 1946 through 1948, about 40 percent of earnings were paid as dividends, compared to 66 percent in 1929 and about 75 percent in 1939.

I believe this change in corporate policy is largely due to the difficulty and expense of obtaining new funds, particularly equity funds, from the public. These equity funds are variously referred to as risk capital, venture capital, or equity capital, and are usually represented by common stocks, except in the case of smaller businesses where there may still be direct ownership by one or more individuals. Common stocks in substance represent a share in the ownership of a business enterprise.

Certain profound changes have taken place in our economy. New money is being obtained more and more by going into debt. In 1946, over 68 percent of all new corporate financing was by the use of debt securities. In 1947, it was over 76 percent, and in 1948 over 84 percent. Most of these debt securities were purchased by insurance companies, and other institutional buyers.

In 1946, common stocks represented about 12 percent of new corporate financing, in 1947 about 10½ percent, and in 1948 only a little over 8 percent. Most of the common stocks went to individuals either directly, or indirectly through investment trusts, in which they purchased participations. The balance was represented by preferred stocks.

When the need for equity capital is so real, why have corporations so largely been forced into debt to get their needed life-blood?

The reason is not because there is not plenty of potential equity money available. According to recent United States Treasury figures, individuals now hold liquid assets—not including life insurance—in the amount of about $200,000,000,000 compared with a figure of about $57,000,000,000 in 1939. These liquid assets are represented by the following:

Government securities	$68, 000, 000, 000
Savings accounts	67, 000, 000, 000
Checking accounts	43, 000, 000, 000
Currency	22, 000, 000, 000

By way of contrast, all stocks listed on the New York Stock Exchange had a market value in 1939 of 46.5 billion dollars; now, in spite of many new additional listings, only about 73.2 billions. Last year less than 15 percent of all the shares so listed changed hands, which means that over 85 percent—some certificates changed hands more than once—of the stocks at the end of the year were owned by exactly the same people who held them at the beginning.

I will try briefly to touch upon some of the reasons for this dangerous trend and some of the possible remedial steps.

World unrest has been a factor with the accompanying policy of costly relief for Europe and huge expenditures for armament, which together postpone the probabilities of substantial tax reduction, even though no war result.

High corporate and individual taxes are undoubtedly a factor. Coupled with this is the double taxation of corporate income, first to the corporation on all its net earnings and then again to the stockholder on the portion paid out in dividends. Some credit to the individual stockholder against his dividend income for at least a portion of the tax paid by the corporation would to that degree make common stocks more attractive.

The combined effect of high individual income taxes and inheritance taxes—including provision for paying them at death—have tended to dry up purchases of common stocks by the upper and middle income groups, which used to furnish the principal field for risk-taking finance.

A vast portion of our national income after taxes has accumulated in the hands of little people. More wealth in the hands of little people is fine. It means more people can have electricity, electrical appliances, telephones, automobiles; but individuals and corporations who pay the taxes must be enabled to carry the burden.

It is natural that these people should seek safety first with their first savings. However, it is unfortunate that circumstances have coaxed such vast sums into so-called safety-first, with such little willingness of the owners to risk even 10 or 20 percent of their savings to own and finance American industry, the very industry that produced these savings. Such policies have caused a rapid flow of vast sums into our insurance companies and savings institutions.

They in turn must place these funds in safety-first chanels. Can they continue to find safety first for such vast and increasing funds? Surely, if such trend continues, there will be no such thing as safety first, for the simple reason there will not be sufficient risk capital down below to provide the safety.

There is another large group of safety-first people. The proportion of national income distributed as pensions and other forms of relief has increased from 1½ percent in 1929 to 5 percent at present. Such distributions now run at some $11,000,000,000 per year, nearly 1½ times all dividends paid by all American corporations in 1948.

Such benefits are fine, provided we enable industry to carry the burden. In the past, industry has been able to raise man-hour output some 2 percent per year. Now it looks like they will have to raise it some 3 or 4 percent per year. Possibly they can, but it will require huge amounts of new equipment requiring billions of risk capital.

In the meantime we see our best men, many of them young, unwilling to take the risks of leaving their present jobs to take bigger and better jobs at higher salaries, simply because they have participations in pension trusts and because increased salaries mean little after taxes.

Additional factors bearing on common-stock markets are the margin requirements and the capital gains tax, which tend to restrict trading, particularly short-term trading, which kind of trading has a definite tendency to modify violent swings in prices either up or down.

The Federal Reserve Board has modified the margin requirements so that you can borrow up to 50 percent to purchase or carry listed securities and to 75 percent to take up new offerings of common stock under a distribution by way of rights to stockholders to subscribe.

The present capital-gains tax is at the rate of 25 percent on all profits after a 6-month holding period and at the individuals' surtax rates if held for a lesser period. Only negligible credit for any losses is permitted to apply against ordinary income. This tax tends to freeze property in the hands of old owners and adversely affects the liquidity of our markets.

This is proven by the fact that it brings insignificant revenue to the Treasury—for 11 years an average of $155,000,000 per year, less than four-tenths of 1 percent of present Federal revenues. At half the rate it would probably produce more revenue for the Treasury and assist in promoting more transactions. This would have the desirable byproduct for both the Federal and State governments of more transfer taxes and for security dealers of more income upon which, in turn, they would pay more taxes.

This is a desirable objective because the market for new or fresh increments of equity capital—whether additional or new issues—is influenced largely by the nature of the secondary markets for securities already outstanding. A good secondary market, listed or unlisted, for older securities, therefore, is the first step toward obtaining a favorable supply of new capital. It follows that a vigorous and active market on the New York Stock Exchange and in other markets, is a desirable thing in itself, and that this is one of the things which must come if there is to be an adequate supply of either new capital for old companies or pure venture capital for new enterprises.

Now who is being hurt? Not primarily the rich man, the rich man has quite, he can live on accumulated wealth, often in large part from interest on tax-exempt securities. Out of taxable income he has nothing to put into industry, and even if he did, plain common sense would dictate that he would be utterly foolish to take the risks with little net return.

These little men who start in business with nothing but the determination to work, sweat, save, and build—the man who starts alone, works alone, saves a little, buys a new machine to increase his production, then employs two or three men—these little men who start as proprietorship, then partnerships, building out of earnings—there are millions of them, there are some 3,700,000 tax returns of unincorporated businesses and only 500,000 returns of corporations—these little men always struggling to get big, which have proved the backbone of our country for generations—these are the men who are being hurt. They haven't a chance to build business from profits.

Let no one think from the foregoing remarks that I am in favor of an unbalanced budget and more inflation. I am not, but what I am interested in is the maximum tax revenues that can be raised without having a depressing effect on business itself, the source of all revenues, whether it be to the individual or to Government. I am clear that raising tax rates from the present all too high peacetime levels is not the way to get more tax revenues, but that on the other hand, some judicious decreases in tax rates may so stimulate business activity as actually to produce more tax revenues in toto. In other words, there is a law of diminishing returns. The recent experience of Canada along these lines is promising and should give us the encouragement to cautiously experiment along similar lines.

Other considerations which must be mentioned in connection with raising capital funds from the public distribution of securities are the time, labor, and expense involved in meeting the requirements of the various Federal Securities Acts with their rules and regulations. These considerations are weighed when the question arises as to whether capital needs shall be met through retention of earnings or through so-called private placements as alternative means to public distribution. I believe that practically everyone in the securities industry thoroughly subscribes to the general principles embodied in the 1933 Securities Act, requiring complete disclosure of information to the investor in connection with a security issue.

However, both the securities industry and the Securities and Exchange Commission certainly since 1940 have recognized that the provisions of the act relating to dissemination of information during the waiting period, and the prospectus delivery requirements have never worked. Representatives of the industry and of the SEC have labored sincerely but unsuccessfully for a number of years past to reach an agreement upon changes which will make the procedures more workable and less expensive.

This problem was referred to by the new Chairman of the Securities and Exchange Commission in an address last week, in which he stated "that the unworkability of the present techniques established in the statute has been apparent for years." He has again held open the door to continued joint study of the problem by the Commission and representatives of the industry, and it is to be hoped that these further conferences will lead to something that may bring to the Congress some constructive amendments to make the act more workable without weakening its fundamental safeguards.

My own opinion is that the registration process itself, requiring as it does complete disclosure, together with the liability provisions of the act for fraud, misrepresentation, and the like, constitute the real protection for the investor. It is doubtful if the average investor can gain very much information from reading himself the prospectus since the prospectus is by nature a complicated, technical, and legalistic document. Nevertheless, the act as interpreted by the Commission, is based on the theory that a copy of the prospectus must reach each prospective investor before he can be effectively solicited to purchase.

This procedure is expensive and even though rules for expediting prospectus delivery have been adopted, the mechanics of prospectus delivery are still highly unsatisfactory. Most prospectuses intended for reading by individuals reach the wastebasket, but of course for those who want them, copies must be available. The average investor must depend upon the advice of their dealers, investment advisers, rating services, and other financial publications, who base their opinion on intelligent study of the prospectus and registration papers by qualified technicians.

The Chairman. You will be present this afternoon, Mr. Hopkinson, at the round-table discussion?

Mr. Hopkinson. Yes, sir.

The Chairman. So that it probably will not be necessary to question you at any great length here. I am prompted only to make the comment that, in my opinion, your emphasis upon the safety-first attitude of small investors is not intended in any way to deprecate the desire of the small investor, like that of the large investor, to protect his savings?

Mr. Hopkinson. No, sir. Quite the contrary, but it is an important factor in trying to open up the equity markets which we are also much interested in.

The Chairman. The real difficulty, then, it seems to me, in our attempt to open up the equity market is to provide the procedure which will convey to the small investor a feeling of confidence that when he does put his money into equities, he is putting it into stocks which are not merely exploitation of the masses of the people.

Mr. Hopkinson. Yes, sir. I think from my own experience in trying to sell equity securities, that the small investor does not realize a common stock really represents ownership or a share in ownership. He looks on it as a piece of paper that is kicked around on the New York Stock Exchange.

The Chairman. You defend the safeguards of the SEC—you do not want to tear those down at all?

Mr. Hopkinson. Quite the contrary.

The Chairman. So that our outlook upon this must necessarily be one of providing a broader base for confidence in the security which is offered for investment, whether it is common stock, debentures, or whatever it may be.

Mr. HOPKINSON. That is right, sir, and providing practical machinery for reaching this great new class of small investors who now have the money to be invested.

The CHAIRMAN. I was particularly glad to have you lay emphasis upon the fact that there is a new class of small investors. I think we can preserve the system of private property if we take the steps that may be calculated to broaden actual ownership and to attach to that ownership also the responsibilities of ownership. I think the knowledge among many people that the responsibilities of ownership in many large enterprises have been divested from the stockholder, just because of the system, is a deterrent to investment in common stocks.

Mr. HOPKINSON. I think you have said that very well, sir, and I think many corporations are alive to that through popularizing, through lunches and speakers and visits around plants, their annual meetings.

I happen to be a director of one corporation which this year is going to hold its annual meeting not in its main office, where it has always held them before, but in a city where one of its important branch plants is located, so that a group of stockholders in a different geographical location will be encouraged to attend.

The CHAIRMAN. That is a healthy change from the old system of having the stockholders meeting in the most inaccessible point.

Mr. HOPKINSON. It is becoming general of the corporations to send out to stockholders a brief summary of the proceedings, including questions asked by unfriendly stockholders, if you want to put it that way.

The CHAIRMAN. Do you care to ask any questions, Mr. Herter?

Mr. HERTER. There is one figure given in your statement here that interests me a lot. You say that all the stock listed on the New York Stock Exchange had a market value in 1939 of 46 billion, and now, in spite of many new additions, only about 73 billion. When you do what is done quite frequently in this committee, translate dollars back to purchasing value in 1939, actually you would find that the real value of all our corporations listed on the New York Stock Exchange at present quotations would be less than they were in 1939.

Mr. HOPKINSON. I think that is probably true, and there is one other factor not referred to in that paragraph, because I do not have any figures on it and have never seen any figures published, and that is the amount of retained earnings that have been reinvested in those corporations between 1939 and 1949.

Mr. HERTER. That is what puzzles me. You would think there is a complete disparity in those figures.

Mr. HOPKINSON. That is right. You see, the savings referred to above in Government securities, savings accounts, checking accounts, and currency, they have gone up four times. Yet the stocks on the New York Stock Exchange in the 10 years have only gone up about a little over 50 percent in spite of many additional listings and in spite of all the retained earnings in American industry over that 10-year period.

Mr. HERTER. The other day we were given figures that indicated about 45 percent of all the wealth of the country—this was taken from the New England figures, but the witness indicated there was no reason to believe it was not true for the rest of the country—about 45 percent of all the wealth of the country was in fiduciaries.

Mr. Hopkinson. I do not know, sir.

Mr. Herter. The figure was given as an estimate, I think, that was made for the New England area. There has been a good deal of discussion here in regard to the relaxation of the regulations with regard to trustees, with regard to life insurance companies, and so on, in investing in common stocks, in equities of one form or another. What is your own impression as to the rules of that kind of loosening up? Would it merely mean you would have a much more active market for the blue-chip securities and that you would have very much more active trading and probably a stronger market for a limited group rather than for the group as a whole?

Mr. Hopkinson. Well, of course, the more your blue chips move up, the more you get a related effect on what we may describe as the less well-known companies, because as the yields get lower on the blue chips, people who want income are driven out of them and they go a grade down, which is proven in both the bond market and the preferred stock market—that in periods of lower yields the spread between the different qualities of securities narrows, when people get worried about the future of business and the safety of their investment, it widens again, which is almost saying the same thing, I think.

Mr. Herter. We also had testimony, I think, from one insurance company, to the effect that in the last 10 years their common stock investments—and they were operating in a State where they were allowed to have common stock investments—had yielded over 9½ percent over that period of time, counting in both the dividends paid and the capital increment.

Mr. Hopkinson. Of course, on capital increment it depends tremendously on where you start your figures. If you take them from the lows of 1937–38 or the low of 1941–42, you can get beautiful figures. If you take them from the high of 1936 or the high of 1946, you get quite a different picture.

So it is largely when you buy as far as that capital increment is concerned, although over a period of years there ought to be a growth trend.

Mr. Herter. Yes, that is again why I am a little bothered by these figures. In terms of the growth of wages and other savings, and so on, this is not proportionate, at all. It is way out of relationship.

Mr. Hopkinson. That is the reason I tried to emphasize it.

The Chairman. Mr. Scoll?

Mr. Scoll. I have no questions.

The Chairman. Dr. Kreps?

Mr. Kreps. None.

The Chairman. I think we are postponing inquiries until later this afternoon. Thank you very much.

Mr. Hopkinson. My own reservation this afternoon is I have to take the 4 o'clock train.

The Chairman. Our next witness will be Mr. Smith.

STATEMENT OF WINTHROP H. SMITH, MANAGING PARTNER, ACCOMPANIED BY WINTHROP LENZ, PARTNER, MERRILL LYNCH, PIERCE, FENNER & BEANE

Mr. Smith. As the last witness scheduled to appear before this committee I am reluctant to plough ground that you have already been over so many times. However, I am vitally concerned with the fact that venture capital is not flowing from the individual saver into business.

For many months I have been hearing speeches and reading articles dealing with venture capital. Most of the discussion is based on the assumption that there is a shortage of capital. This, of course, is simply not so. There is plenty of capital and there is still alive much of the venturesome spirit. But stock ownership is seldom considered today, even by those willing to bear risk, as an outlet for their funds. Many people who have money either are completely ignorant of investment principles or actually believe that common-stock investment is a sure way to lose their savings.

I know that this committee is anxious to increase and stabilize the flow of equity capital. I wonder, however, if we are all thinking and talking about the same thing. What is this equity capital, or venture capital, or common-stock capital that everybody seems so interested in these days?

I think we can answer this question only in terms of people. Assume that you have, through the exercise of reasonable frugality accumulated $1,000 in your bank account above your normal reserve. So far as you are concerned the money is lying fallow and you want to put it to work so that it can either earn something for you or grow.

That $1,000 of yours is equity capital if you, individually, personally and of your own volition decide to put it into ownership—common stocks, for example. If you as an individual decide to put it into debt—an annuity, for example—that $1,000 is not equity capital. The $1,000 doesn't change. It is your decision that counts.

Venture capital is a state of mind.

In the eyes of the SEC the investor is a very important fellow. Our whole fabric of securities regulation was designed to protect him. The Government did a good job. Those who framed the legislation had their eyes on the right target. Inevitably a few shots went wide. Other representatives of our industry have already told you of a few detailed improvements that we believe could be made. But the thing I want to emphasize is that the objective was the right one—protect the individual investor and give him a run for his money.

Despite the fact that the SEC was lifting up the investor and giving him a new dignity and a new importance, the man in the street apparently was little influenced. The most recent Federal Reserve study of consumer finances shows that about 69 percent of the people making $3,000 a year or more do not think a man should invest his savings in common stock. Only some 8 percent of this group believe that common stocks are desirable things in which to put one's savings. Of the 69 percent opposed to common-stock investment, 34 percent said they were opposed because they were not familiar with common stocks and 28 because they did not believe common-stock investment was safe.

This attitude of aversion toward stock ownership is in no sense confined to those who had unfortunate personal experience with the market crash and its aftermath, but has been so inculcated in the minds of our younger people that we have raised a whole generation that seldom even thinks in terms of equity investment.

Another thing that has happened to people who have money, who know about investments and are not afraid to take a chance is that our tax structure is so formed that it is not profitable for them to invest—or at the very least, they think it is not profitable.

It seems to me that there are two lines of attack open to us. One is through education, the other is through some positive Government action in the realm of taxes. First, I'd like to talk about the reeducation of our potential investors because I know more about that problem. We at Merrill Lynch have made, we think, great strides, but we need help from the rest of our industry, from business and from the Government itself. I am convinced that if we get this help, we can change the whole psychological climate in which the investor operates.

The interest and sympathy this committee has already shown is in itself a tremendous step forward in Government recognition of the ownership problem. But we need more than sympathy. We need concrete action—action taken frankly and openly in the interest of the man willing to bear risk.

I have been much impressed with the series of booklets prepared and distributed by the Department of Commerce to help small-business men. One booklet, Establishing and Operating Your Own Business, is a real gem. In understandable and attractive prose it sets forth the advantages of running your own business, balanced, I think very fairly, by the disadvantages. The whole tenor of the booklet, however, would certainly give anyone reading it the deep conviction that our Government was sincerely interested in seeing the small-business man succeed and was anxious to help him.

I would like to see the Congress appropriate some money to permit the Securities and Exchange Commission to do the same thing for investment that the Department of Commerce is now doing for small business. I realize that this suggestion puts me in a peculiar position of asking the Government to spend more money. It won't be much, however, and may well be a self-liquidating venture.

The CHAIRMAN. May I interrupt?

Mr. SMITH. Yes, sir.

The CHAIRMAN. As a member of the Appropriations Committee, I have heard that same statement made over and over and over again by those who advocate new expenditures by Government, and I am glad to be able to say to you, sir, that most of them are right.

Mr. SMITH. I said this with some trepidation. Also I am going to quote a few figures that I think will show you it would not cost too much.

The CHAIRMAN. Very well.

Mr. SMITH. Less than 2 years ago we published a booklet, How To Invest. Already we have given away more than 250,000 copies, at a cost to us of approximately $30,000, or about 12 cents each. In it we tried to do just about what the Department of Commerce did in its booklet—explain the principles of investment, giving full recognition to its opportunities and its dangers, but leaving the reader sympathetically disposed to the general idea.

This booklet of ours has had a most favorable reception. We have gotten thousands of new customers, over a hundred universities are using it in the classrooms, and we have received bales of compliments.

A similar booklet, however, that bore the stamp of approval of our

Government would have a more profound influence. It would demonstrate by its very existence that the Government believed in and favored investment. Whether justified or not, there are hundreds upon hundreds of potential investors today who are convinced that the Government is still actively hostile to the buying of stocks.

Such a booklet, sponsored by the SEC or some other department of the Government, would also be more likely to be accepted than a similar booklet sponsored by a commercial house like ourselves that can be criticized as a prejudiced party. Finally, such a booklet would put into the hands of the smaller broker-dealer-underwriter, at a cost he could afford, a sales promotion and educational tool that is today beyond his individual resources.

As a matter of fact, I would like to see the Congress provide the necessary funds to issue a whole series of booklets designed to explain the functions of the SEC, to explain investment and to help the individual saver invest his funds wisely. Today the material put out by the SEC, while thoroughly competent from the legal and accounting viewpoint, is about as much help to Mr. Average Investor as a copy of the national budget would be. It's much too technical.

I also said that the Government could help the flow of venture capital by some modification of our tax laws. I do not pretend to testify here as a tax expert. I would like to call the committee's attention to the fact that our partners, through the Merrill Foundation for Advancement of Financial Knowledge, founded in 1945, have given to Harvard University $225,000 for a study of the effect of taxes on business. This study has been under way for nearly 2 years and is expected to be completed next year. Secretary Snyder has already shown interest in the information collected and when the study is completed it will be made available to the Government.

But, there is this much that I do know, even prior to the report of the Harvard study: A great number of our present customers repeatedly mention taxes as a reason for their extreme conservatism. Taxes are also frequently mentioned to us by prospects as the reason that they will not become customers.

This committee has already been presented with several suggested modifications of the tax laws that should encourage investment, and several comments of the chairman indicate that the committee believes at least some modification is desirable. My only plea is this: that the Congress take some step, however small, specifically and admittedly designed to help the investor.

I realize that no great reduction in taxes is possible. However, some concrete proof that our Government is sympathetic toward equity investment, will certainly help in the over-all educational and confidence-building job that must be done. Our industry, I am sure, would seize upon such a gesture from the Congress as a landmark in the rapproachment between the investor and his Government.

To my way of thinking, the attitude of the man holding savings determines whether it is going to be venture money or debt money. Ignorance and apathy are our two biggest deterrents to equity investment. I would like to have the Government help us attack them both through the twin devices of education and greater inducement to invest.

There is one question that may come to your mind in connection with these suggestions and that is this: Apparently these proposals are directed primarily toward improving attitudes toward existing securities. In a sense this is true, but it is all part and parcel of the same picture.

When you as an individual decide to invest your $1,000 you will, if you are prudent, examine all of the ways you can put it to work. When fine companies with many years of regular dividend payments are selling on the stock exchange at 3, 4, or 5 times their annual earnings, you are not going to be willing to put your money in a new venture that earns less—or nothing at all. You will not be tempted to invest in a new business when stock prices are so depressed that you can find a dozen good securities listed on the exchange that are selling for less than their break-up value, ignoring plant and good will.

You can't raise capital for new business when investors are not actively interested in buying a share of existing businesses. No investment banker can sell new common stocks when the stock exchange is in the doldrums. The economist considering the new capital problem cannot ignore this fact, because the individual man with the $1,000 won't ignore it. He is the fellow who decides whether there is going to be equity capital, not the economist, not the insurance company president, not the investment banker, not even the corporation president.

Our problem is really a problem of people and their money.

The CHAIRMAN. Mr. Herter?

Mr. HERTER. One question with regard to the reluctance of people to buy common stocks: How much do you run into the worries that occur from time to time that the income they will get from their investments is likely to be a very spotty income. In some years they will get a high return and the taxes will absorb a large part, and the next year will be a bad year and they will get a poor return in dividends and that the tax and retention laws discourage corporations from trying to accumulate reserves in a legal manner, which would allow a steadier basic underpinning in dividend rates?

Mr. SMITH. If I understand your question correctly, you are not referring—or are you referring to the changes in dividends or are you referring to changes in taxes?

Mr. HERTER. Changes in dividends and the fact that unusually large dividends are likely to put people in a different tax bracket where the Government takes a considerable portion of what they get in dividends. When they are paid out in a given year through extra dividends the shareholders may feel they would much rather have an even income over a longer period of time than the sporadic income that comes from payments that are made irregularly.

Mr. SMITH. I do not think I could answer your question in a general way because individuals have so many varied problems according to their age, their other income, and their total wealth, but very definitely, of course, people do like a steady income, and certainly some people are going to hesitate about putting money into common stocks if they think their income is going to fluctuate; but to make a general over-all statement, I do not think I could, because everybody's problem is so different.

Mr. HERTER. Again from the point of view of the tax law, you do not feel that the retained earnings provision of the law prevents corporations from accumulating, let us say, a cash surplus as in a given year, having a very conservative dividend policy to accumulate in order to be able to make steady payments over a period of years?

Mr. SMITH. All corporations are very mindful of that provision of the law if they are approaching what we might say is the point when that provision would become effective. Does that answer that portion of the question?

Mr. HERTER. Is it not a great temptation to them in good years to reinvest a considerable portion of their earnings in plant, equipment, and so on, rather than take a chance on a later stock flotation and set aside some of those earnings as a reserve for later dividend payments?

Mr. SMITH. Most of the corporation presidents that I know and am familiar with want to build up their reserves in good times, both in order to preserve their continuity of dividends and also so that they will not have to come to the capital markets when times are bad.

Mr. HERTER. They would much prefer not to come to the capital markets if they can help it?

Mr. SMITH. Naturally. I do not believe they are different from anybody else. No one wants to borrow if he can avoid it.

Mr. HERTER. In effect, what your testimony is, is it a plea to make the person of small savings conscious of the equity market?

Mr. SMITH. Not exactly. I am not making the plea just for the small man. These figures that I quoted from the Federal Reserve study show that it is not just the small man who is not investing. There are people of very substantial means who are not investors in common stocks. So I am pleading to educate really the entire segment of the public including many people of substantial incomes.

Mr. HERTER. What is your own impression of the receptivity of people to investment trusts that have their holdings largely in common stocks?

Mr. SMITH. There are two types of investment trust. Which are you referring to?

Mr. HERTER. I am speaking of the open end.

Mr. SMITH. I want to make sure I understand that question. Would you mind repeating it again?

Mr. HERTER. What is the receptivity of the customers that you have come in contact with—and I take it you probably come in contact with more customers than any concern in this country interested particularly in equity investments—to the equity trusts? We were told that they were increasing at the rate of three to five hundred million dollars a year. Do investors prefer to get to the diversification that comes through investment trusts even though they sacrifice a part of their income in the process?

Mr. SMITH. I am afraid I am not the one to ask that question of, because our firm does not deal in investment trusts at all, open-end trusts.

Mr. HERTER. Only individual securities?

Mr. SMITH. That is right. We have nothing to do with investment trusts, so I think perhaps somebody else would be better qualified to answer that question than I.

Mr. HERTER. Thank you.

The CHAIRMAN. Mr. Smith, if I had planned the testimony this morning of Mr. Hopkinson and yourself to support the proposal of the Temporary National Economic Committee that Congress should pass a law to establish national standards for national corporations, I do not think I could have done a better job.

Both of you have emphasized the importance of confidence on the part of the owner of savings in the securities which represent ownership of industry, and both of you suggest methods by which Government may help to do this.

To you, Mr. Smith, I want to say that I do not believe your suggestion to this committee is that the Government should itself undertake actively what you and your well-known firm are doing in actively promoting the sale of common stocks to investors. The Government cannot very well become a salesman. That is not your suggestion?

Mr. SMITH. Oh, no.

The CHAIRMAN. Your suggestion merely is that the Government should and must provide incentives in one way or another. I was interested in your statement that many people who have money either are completely ignorant of investment principles or actually believe that common stock investment is a sure way to lose their savings. This is especially significant in view of your statement on page 2, "but the thing I want to emphasize is that the objective was the right one"—that is, the objective of the Securities and Exchange Act—"to protect the individual investor and give him a run for his money." A most desirable objective indeed, I think we must all agree is to protect the individual investor and give him "a run for his money."

Mr. Hopkinson tells us that corporations instead of going to secluded places to hold their stockholders' meetings, are now tending to hold them in places which are accesible to the stockholders. That, of course, is very educational, but it sems to me it all supports the contention that Senator Borah and I made when we first introduced the bill to provide national standards, namely, that if the Federal Government through law establishes the rule of responsibility for management, for corporate activity, it will create the climate which will invite investment.

Testimony before this committee is clearly that investment today and the savings of the people by institutions, by the insurance companies, and by the investment trusts and the like, so far as it goes to debentures on the part of insurance companies, so far as it goes to blue chips on the part of investment trusts, and the like, is an investment in management.

Now, the wealthy individual is in a position and an investment trust is in the position to appraise the responsibility of management. The little fellow with a thousand dollars, of whom you speak, is not. He cannot do it; and if it is not done for him by the Government, it will not be done. That is why the SEC law was passed, in order to provide safeguards so that the issuance of securities would not be used as an instrumentality, as it was so frequently the case in the past, merely for exploiting the unwary investor.

So the next step, it seems to me, is clear: To establish national standards for these corporations. The great impediment to that, I think, has been the conviction of many in business, who have not taken the time to study the proposal, that it means only expanding the power of Government to control and to regiment business. The curious fact is that it would do precisely the reverse, because by setting up standards that were known to the people and recognized by management, it would diminish the requirement for discretionary Government interference with business.

The opportunity to deliver that lecture was too good to miss.

Mr. Smith. Mr. Senator, all of what you said is true, but I think that there have been excellent standards already set up to protect the investor. Perhaps others could be added. But what I have been trying to bring forth—and I am not pleading for the $1,000 man, I am going way above that, too—is to let the investor know that he does have great protection even today. I do not believe he is aware of it.

If he was aware of some of the excellent standards that are in existence, I think then he would lose his fear and he would gain knowledge and would be a purchaser of equity securties, but it is an astounding fact, as these Federal Reserve figures show, that 92 percent of the people of the United States do not own common stocks. It is an amazing thing.

The Chairman. While you still permit corporations to issue nonvoting stock, while you still permit the issuance of management stock, to a very infinitesimal portion of the actual ownership, you create the base out of which lack of confidence arises. When management is in a position, even though the management of most companies may not practice any abuses at all, but while that possibility still exists you have the basic reason why 69 percent of the people, as quoted in your paper, veer away from investments in common stocks.

Mr. Smith. Mr. Senator, I am as aware as you are that there may be bad practices in a few companies, but by and large, particularly on the securities that are listed on the Stock Exchange—there are exceptions, but by and large—they are managed by men of integrity and character.

The Chairman. I will quite agree with that, and I want nothing that I have said at any time to convey the impression that I have any other belief. I think that the standards of business management are much better today than they were a generation ago, much better, no question about that. We could not possibly have had the testimony that you and Mr. Hopkinson gave here this morning 25 years ago.

Mr. Smith. So I am inclined to disagree with you to a little extent, that it is the few exceptions that cause the reluctance. I will go back to my original statement. I think it is to a very, very large extent just ignorance. That is not confined to the little fellow.

I have seen time after time successful, very successful, businessmen with almost no knowledge whatsoever of investments.

The Chairman. Well, let me ask this. Why do people put their savings in life insurance? It is because they have confidence that public safeguards have been erected around the activities of management in life-insurance companies, which will prevent them from investing those savings in issues or in ventures that are not sound.

That is why every legislature in the United States long before this problem of investment became so much a national concern was providing public safeguards. Nobody would pretend to suggest that the State protection, State investigation, State regulation, should be abandoned. We have just moved into another era in which the national aspect of investment is so much greater than it ever was before, and the little fellow with a thousand or the fellow with five thousand or the fellow with ten thousand, living in a distant community, knows nothing about the management of the blue-chip stocks and cannot very well acquaint himself with it.

So when he does not find an avenue, a local avenue, with which he can personally become acquainted for the investment of his savings, then he turns it into these other institutions which he knows from experience are under public supervision.

Mr. Smith. That is perfectly true. Life-insurance companies have the confidence of the public. They deserve it by the way they have handled themselves, and because of excellent public relations.

Not to disparage the life-insurance companies, though—and I own life insurance and always have—a person who has bought life insurance, let us say 10 years ago, and if he dies, his estate is not going to have the purchasing power that he thought it was going to have when he bought it. That is in no way to disparage life-insurance companies, because they have a contractural agreement with their policyholders to pay back a certain amount of dollars and they cannot help it if the purchasing power is different.

Possibly the public may, as they come to realize that the purchasing power of the dollar may decrease, come to think that common stocks are rather attractive, too, providing that knowledge is brought to them.

You said a moment ago: How can the man at a distant point find out something about common stocks? In our very small way we have been trying to bring them to his attention, but one firm alone cannot do it. The problem is too great. That is why I say if we can get the Government to give some assistance from an education standpoint, it will bring knowledge to the man out in the country.

Of course, the Government should not attempt to induce the man to buy common stocks, but it can educate him and point out the advantages and the risks that he should inquire into in making up his mind whether or not he should buy them. That is all I am asking for.

The Chairman. Yes, of course, and all I am saying is that the Government can best do that by establishing national standards of responsibility for management, minimum national standards, and then turn management free, operating within those standards.

Mr. Smith. It can do that, but then that is not enough. You have to tell the public that you have done that.

The Chairman. Oh, well, we will do that if we get to that point.

Any other questions?

Mr. Scoll. I have just one question.

Mr. Smith, do you think that the ignorance of people about common-stock investment or their reluctance to purchase common stocks today may be in part the result of a sort of hang-over from the boom and bust in the 1929 collapse?

Mr. Smith. I do not think there is any doubt about it. There are not only those who may have been affected by the crash at that time, but those, the younger people who have heard it from their fathers in their homes. I do not think there is any question about that.

However, even before that there still was a very small number of people who were common-stock holders.

Mr. Scoll. Of course, at the peak of the boom there were a great many people who owned stocks or who were speculating, perhaps not even owning them but just speculating and trading on margin from day to day.

Mr. SMITH. Unfortunately, though, people that owned real estate, people that had bank deposits also lost very, very heavily, too. It was not just stockholders who were affected but, of course, it has had a tendency to destroy confidence.

Mr. SCOLL. It was one of those really sort of catastrophes, if you might call it such, in the history of a people, an economic catastrophe, and it is pretty hard to educate people out of that memory in one or two generations.

Mr. SMITH. It is very hard to, but people who were speculating in real estate, people who even owned real estate outright, took great losses. The stock market was more publicized.

Mr. SCOLL. The Florida boom received its share.

Mr. SMITH. Yes. But a great deal of confidence has been restored, however, in Florida, and a great deal of confidence has been restored in the stock market, but not as much as I would like to see.

The CHAIRMAN. Dr. Kreps?

Mr. KREPS. Mr. Smith, do you regard investments as a highly specialized profession?

Mr. SMITH. Yes; I do.

Mr. KREPS. Requiring a considerable amount of knowledge and information?

Mr. SMITH. Yes.

Mr. KREPS. Do you think that the ordinary small professional man with an income of from $10,000 to $25,000 can acquire that knowledge in addition to the competitive process of being excellent in his own profession?

Mr. SMITH. I would not expect that he would be what I would call a specalist, but I think the ordinary businessman who is willing to spend some time and go to the right sources and do a little work can get sufficient knowledge so that he can handle his own investments very satisfactorily.

The CHAIRMAN. Dr. Kreps, are you talking about the average college professor?

Mr. KREPS. Or doctor or lawyer.

Mr. HERTER. Or politician?

Mr. KREPS. Politician, possibly.

Mr. SCOLL. You remember you said ten to twenty-five thousand a year.

Mr. KREPS. I said 25,000 to include the lawyers.

Mr. SMITH. I would like to just follow that up for a moment. That is a very good question, and it is a question that gives me great concern. We have people come to see us and they virtually say, "I have got so many thousands of dollars, will you please invest it for me as you see fit?"

In other words, they have complete confidence. I have been talking about lack of confidence, but there are thousands and thousands and thousands of our customers who have complete and utter confidence in us. But we will not do that, and when anybody comes in and says that to me, I say, "After all, this is your money. If it is invested wisely, if you get a good return, if you happen to make some money, you are going to benefit, I am not. If you lose money, you are going to lose your money. It is not going to be my money that you have lost. You have worked hard for that money, spent years in accumulating it. Now, in my opinion, it is utterly foolish for you, who have spent these years accumulating that money, to come in and expect somebody to do the job of investing it for you. We will help you. We will give you all the advice, all the figures, everything at our sources, but at least you ought to be able to do some hard work in the evening studying up on some of the problems. We will tell you what to read, we will help you. Then we want you to come back, we will give you the advice, we will give you figures, but you have been a successful businessman and there is no reason why you cannot make a decision just as well as we can."

But that is a very difficult thing to get people to do.

Mr. Kreps. They have a sort of reverence for the authority of the specialist.

Mr. Smith. Yes; I think so.

Mr. Kreps. I am glad to hear you say that investment in a specialized profession, because I was just considering withdrawing it from the curiculum of the graduate school in which I teach and in which we sometimes start by using your very useful pamphlet. I ought to add that it is only the first day of the course.

Mr. Smith. I would say it is a very excellent way to start your course.

Mr. Kreps. I agree. As we get further on in the course, certain other things come into the purview of the student. One is the available evidence concerning the percent of the accounts of individuals trading with brokerage concerns, that over a period of years show losses. We try to get at the investment experience of the small person, who has not or will not take, the time from his profession, from his daily activities, the leisure time you suggested he should take, that evening when he is tired, the fag end of his energies, to find out for himself. He has to rely on somebody else.

Have you any idea what that mass of evidence tends to show about the small investor? I will say that thus far—and I wish further evidence would become available—the record indicates that between 80 and 90 percent of the accounts of small investors in such houses show losses.

Furthermore, we find pretty soon that when the public is in the market or is urged to get into the market, that is invariably the wrong time. The public tends to come in when the market is high and tends not to be in the market when the market is favorable, so much so that there is, I believe, a sort of standard maxim in the "Street," "If the public wants to buy, sell them."

Frankly, there are a number of people today in the small-investor group who wonder about this deep concern to distribute securities at this time. The pattern looks too familiar.

How will you overcome that reaction? I will not go on except to point out that anybody who is a lawyer, doctor, or occupational specialist of any kind cannot acquire the technical information and the knowledge about management which is the crucial variable. If you do not know management in a security, you know nothing practically. Buying and selling stocks at the right time is a game which only experts can play.

Mr. Smith. Dr. Kreps, you have asked me a question which is really a statement.

Mr. Kreps. That is right.

Mr. Smith. I think you have started off on the wrong premises, because I was talking about an investor. You have called him an investor but you are really talking about a speculator. They are two entirely different people, two entirely different classifications.

I have agreed with you that a knowledge of investments will take time and work to acquire, but when we are talking about a speculator we are talking about an entirely different person. There are very few people, in my opinion, who have the knowledge, the adaptability, the feel, a certain native ability to speculate that are qualified to speculate and, therefore, when you tell me that some 80 percent lose money, you were not talking about investors, you were talking about speculators.

I am not surprised at those figures, because the average person is not and he should not be and he should not be encouraged to speculate.

Mr. Kreps. I take it, then, you would disagree in part, at any rate, with testimony offered previously which directly, after speaking of the fact that last year less than 15 percent of the shares listed changed hands—which means that over 85 percent of the stocks at the end of the year were owned by exactly the same people who held them at the beginning—states, "I will briefly touch upon some of the reasons for this dangerous trend."

The 85 percent held in strongboxes would represent investors' accounts; would they not?

Mr. Smith. Yes.

Mr. Kreps. Would you regard that, therefore, as a dangerous trend?

Mr. Smith. You are talking about whether held in strongboxes or not. That does not always make a person an investor just because he holds it in a strongbox. A person can hold a security outright in a strongbox and still be very much a speculator.

Mr. Kreps. Isn't he a speculator anyway? If you have dollars, aren't you speculating on what the value of the dollar is going to be?

Mr. Smith. Maybe we had better get back to the actual definition of the word "speculator."

Mr. Kreps. That is what I am trying to get at, what is your definition?

Mr. Smith. As far as securities are concerned, that is a very hard word to define. I am using "speculator" more in the common term, and I do not think we can get down to the close definition of it—somebody who is much more concerned with trying to make an appreciation rather than investor income. Then the degree of his speculation is going to depend upon the type of securities that he uses as a medium for the speculation.

Mr. Kreps. In the absence of some sort of standards by which management can be judged, you tend to agree with me that the small investor, the man in the 5- to 15- or 25-thousand-dollar field, has to accept somebody's word or somebody's advice somewhere?

Mr. Smith. I do not think he has to. I would prefer that he did not. We can gather information for him, facts and figures, far better and faster than he can ever get them for himself; but I would prefer that, after he gets those, he study them and then, if he wants to come in and seek our advice, we will be glad to give it.

Mr. KREPS. Aren't you using the wrong gender?

Mr. SMITH. Pardon me?

Mr. KREPS. Shouldn't you say "she"?

Mr. SMITH. I should say "they."

Mr. KREPS. Is it not a fact that most of the securities of the United States are owned by women and that these women rarely have information even about a particular business? I doubt whether some would understand the risks of investment in stocks even after they had read some of the technical terminology which you define——

The CHAIRMAN. Wait a minute. As the senior Senator from the State which first gave women the vote, the State which first had a woman governor, I protest.

Mr. HOPKINSON. Senator, might I interpolate for just a moment?

The CHAIRMAN. Yes.

Mr. HOPKINSON. After referring to the static nature of such a large percentage of shares on the New York Stock Exchange, Dr. Kreps referred to a phrase in the following paragraph about this dangerous trend.

The trend I was referring to was not just that, but more primarily the trend toward increasing percentage of debt financing an dso much of the savings going into the kind of things that are referred to—Government securities, saving accounts, checking accounts, and currency—rather than that only 15 percent of the stock turning over being a dangerous trend. That was merely an illustration of the lack of liquidity in the market, but the trend I am referring to is primarily this trend into other forms of investment.

Mr. KREPS. Thank you, sir.

The CHAIRMAN. We are very grateful to you both for your presentation here this morning. We will welcome you back at the afternoon session.

I neglected to state at the outset that Secretary Sawyer of the Department of Commerce communicated with me yesterday afternoon and he has made available to us, for participation in the round table this afternoon, Mr. James L. Kelly, the Assistant Director of the Office of Domestic Commerce, and Dr. James C. Dockeray, Chief of the Finance and Tax Section in the Division of Small Business. There will also be present a representative of the Federal Reserve Board.

We will welcome you gentlemen when you return at 2 o'clock.

(Whereupon, at 12 noon, the committe adjourned, to reconvene at 2 p. m. on the same day.)

AFTERNOON SESSION

Present: Senators O'Mahoney (the chairman) and Flanders and Representative Herter.

Also present: Oliver M. Whipple, financial vice president, Mutual Life Insurance Co. of New York; James L. Madden, second vice president, Metropolitan Life Insurance Co., New York City; Edward Hopkinson, Jr., partner, Drexel & Co., Philadelphia, Pa.; Winthrop H. Smith, partner, Merrill Lynch, Pierce, Fenner & Beane, New York; and Dr. A. D. H. Kaplan, Brookings Institution;

James L. Kelly, Assistant Director of the Office of Domestic Commerce, and J. C. Dockeray, Department of Commerce;

David E. Scoll, Theodore J. Kreps, Grover W. Ensley, William H. Moore, and Fred E. Berquist, of the committee staff;

Albert R. Koch, Federal Reserve Board, Division of Research.

The CHAIRMAN. We will take a census of those present.

Beginning with you, Mr. Whipple, and going around the table, just give your name and your association to the reporter.

Mr. WHIPPLE. Oliver M. Whipple, financial vice president, Mutual Life Insurance Co. of New York.

Mr. MADDEN. James L. Madden, second vice president, Metropolitan Life Insurance Co., New York.

Mr. HOPKINSON. Edward Hopkinson, Jr., partner, Drexel & Co., investment bankers, Philadelphia.

Mr. SMITH. Winthrop H. Smith, partner, Merrill Lynch, Pierce, Fenner & Beane, New York.

Mr. KELLY. J. C. Dockeray, Department of Commerce; James L. Kelly, Department of Commerce.

The CHAIRMAN. And the staff members, Mr. Scoll, Dr. Kreps, Dr. Ensley, Dr. Moore, and Mr. Berquist.

And Dr. Kaplan.

Dr. Kaplan, this is the final session of the hearings of the Subcommittee on Investment, the opening sessions of which were held on September 27, 28, and 29, and at which you testified, contributing a most stimulating paper, in which, among other things, you discussed the desirability of establishing a new form of capital bank in order to make equity capital available to small business. That suggestion of yours has been discussed on various occasions during the hearing.

When the insurance companies were represented, the testimony that was presented here by the insurance companies emphasized the problem which we are discussing, the two problems, so to speak, the first of which is the lack of equity capital for new business, and even for old business, and the second of which is the difficulty of even getting debt capital for little business. The loans, institutionalized loans, go largely to the bigger units, and even the investment trusts invest primarily in blue-chip stocks.

We have discussed the establishment of such organizations as the American Research & Development Co., designed to take advantage of opportunity for risk capital. We have had very stimulating papers from all the witnesses and particularly today from Mr. Hopkinson and Mr. Smith, who are both here.

So, the purpose of our meeting is to discuss some of these various proposals. Inasmuch as the insurance companies when they were present indicated their willingness and their desire to furnish loans to small business, and inasmuch as we discussed, while Mr. Lincoln of Metropolitan was on the stand, the possibility of opening the door to the investment of insurance funds to small business through the participation of local banks, and inasmuch as Mr. Whipple, representing the Mutual, was one of the insurance people who indicated an interest in this matter, perhaps we better let you gentlemen start the ball rolling. You may address your questions to anybody here.

Before we start, and as part of this morning's record, Mr. Smith would like to ask a question of Dr. Kreps, concerning the exchange had this morning.

Mr. SMITH. Dr. Kreps, when you were questioning me this morning you made a statement in which you said that in certain standard text-books it was shown that between 80 and 90 percent of small investors lost money. I wonder if you would be kind enough, for the record, to be more specific as to the sources of that information and also as to the intervals of time over which the studies were made.

Mr. KREPS. I will be glad to put such a memorandum in the record, sir. It would consist of a summary of studies that have represented various periods of experience in the 1920's and 1930's. I don't know whether there are any in the last 3 or 4 years; I imagine not. Those accounts have not yet been closed, possibly. At least the occasion for closing such accounts—namely, a depression—would not seem to have occurred. But I shall be glad to put such a small memorandum in the record at this point.

Mr. SMITH. Thank you.

The CHAIRMAN. That will be made a part of the record.

Mr. HERTER. I think it is unfortunate to have that statement made public at a time when we are talking about the desirability of more equity capital in our economic structure. The statement is unsupported, as I see it, except by studies that may be very old. I think for the record it should be made clear that there are no supporting data at the moment and that the studies referred to may have taken in a period that included a crash and are not necessarily in any way indicative of the general trend with respect to the stockholdings at the present time.

Mr. KREPS. It is impossible for me to refer to anything except facts; and such facts as are available, sir, are of this order.

The CHAIRMAN. But they don't refer to the present.

Mr. KREPS. They do not refer to the present.

Mr. HERTER. I think that ought to be made very clear.

Mr. KREPS. I am making no prophecy about the future. The best most anyone can do is to refer to the facts available without trying to make any implication that they may be repeated in the future. I quite share your view and your emphasis tHat these studies represent, as so often happens, what happened historically. There is no implication that history will repeat itself.

The CHAIRMAN. We are doing our best to change conditions, if I may use that phrase, so that history won't repeat itself.

Mr. KREPS. Let's hope it never does in this particular regard.

(The material above-referred to is as follows:)

MEMORANDUM IN ELABORATION OF THE OBSERVATION MADE BY T. J. KREPS

"Thus far—and I wish further evidence would become available—the record indicates that between 80 and 90 percent of the accounts of small investors in such houses show losses."

Perhaps the best known, careful statistical study is the book by Dr. Paul Francis Wendt entitled The Classification and Financial Experience of the Customers of a Typical New York Stock Exchange Firm from 1933 to 1938, Columbia University, 1941.

Dr. Wendt, with 8 years' practical experience as a customer's broker, had access to a wealth of original documents. He summarized his statistical results under the guidance of the eminent statistician, Prof. Frederick C. Mills of Columbia University. Among other experts who assisted him, he acknowledges the "constructive criticism of Dr. Charles O. Hardy of the Brookings Institution."

For obvious reasons he rejected the evidence of small investor experience during the abnormal boom and bust from 1922 to 1929 to 1933. That was characterized in many respect by an unusual speculative mania which attracted somewhat ingenuous participation by relatively uninformed segments of the public. Dr.

Wendt wisely limited his analyses to the period 1933 to 1938. In addition to being a less abnormal investment cycle, it was a period during which the investors, having just witnessed the 1929–32 catastrophe, were probably reasonably olert.

Table 104 printed on page 185 in Chapter VIII, Summaries and Conclusions is illustrative of his findings:

Median results and percentages of accounts showing profits after adjustment for book profits and losses for 239 accounts of the 1937 study and 797 accounts of the 1938 study

Classifications of accounts	239 accounts, 1937 study		797 accounts, 1938 study	
	Percentage of accounts showing profits	Median profit or loss	Percentage of accounts showing profits	Median profit or loss
Types of accounts:				
Trading and speculative	24.7	−$364	27.0	−$405
Investment	18.9	−366	19.8	−553
Invested capital:				
Under $5,000	20.9	−151	24.1	−332
$5,000 to $19,000	13.3	−1,230	25.1	−1,854
Over $20,000	18.7	−2,540	35.2	−3,583
Year of first transaction:				
1933	--------	--------	33.4	−317
1934	29.3	−428	32.1	−277
1935	32.0	−339	26.0	−442
1936	20.2	−407	10.0	−586
1937	4.8	−352	7.7	−443

The 2 years of least dissimilarity to 1948 and 1949, the years in which greater public participation is being sought, are the years 1936 and 1937. Note that of those who made their first transaction in stocks in 1936 only 10.0 percent showed a profit in 1938. Of the accounts which recorded their first transaction (purchase, short sale, put, call, etc.) in 1937, 92.3 percent showed losses a year later.

Dr. Wendt made a clear distinction between trading and speculative accounts versus investment accounts. He found that a reliable sample for the period 1933 to 1938 showed that 27.0 ± 2.0 percent of the trading and speculative accounts showed profits. (The figure, ± 2.0 percent is the standard deviation, an authoritative statistical estimate of sampling error.) On the other hand, only 19.8 ± 3.1 percent of the investment accounts showed profits. That is 80.2 ± 3.1 percent showed losses.

The smaller accounts had the least favorable investment experience. A comparison of tables 73, 74, and 75 in Dr. Wendt's study shows that for accounts with invested capital of $20,000 and above, the percent showing losses was 64.8 ± 5.6 percent, the median account showing a loss of $3,583. For accounts of $5,000 up to $19,000, the figure was 74.9 ± 3.7 percent with the median account showing a loss of $1,854. For accounts with an invested capital less than $5,000 the figure was 75.9 ± 1.8 percent with the median account showing a loss of $332.

There are several other original studies of variable quality and, of course, second-hand references. A good deal of original evidence, such as it is, is to be found in the investigations and hearings which set up the Securities and Exchange Commission. Voluminous facts are likewise to be found in their periodic publications of Selected Statistics on Securities and Exchange Markets.

Well-known popular accounts of the same tenor as Dr. Wendt's study are such volumes as Kemper Simpson's The Margin Trader, Harpers, 1938, or such articles as Conrad Alexander's Who Wins in Wall Street in Barron's Financial Weekly in the issues of September 12, 19, and 27, in 1938.

The Chairman. The questions which I read this morning, of course, were before the members, those who participated in the morning session. They are not before those of you who are coming now for the first time. Let me read the first question that I presented this morning, at the outset:

Is it possible for small and intermediate business to obtain its capital requirements through existing channels, having in mind that—

(*a*) The current high yield on seasoned common stocks make it difficult to float small common-stock issues at reasonable cost;

(*b*) Credit requirements for long-term loans by life-insurance companies limit life-insurance investment to established companies regardless of size with stable earning records and favorable debt-equity ratios; and

(*c*) Institutional investors in investment trust companies are similarly limited as to the types of investments which they can make?

Mr. Whipple, or Mr. Hopkinson, does either one of you wish to kick off the ball?

Mr. Whipple. To reply to that question, Senator, the first part of which deals with equity: Of course, as to life-insurance companies doing business in the State of New York, that part does not apply, as we are not permitted to invest in equities, as you know.

The second part of the question, as I understand it, deals with whether or not small business can expect to obtain debt financing from the life-insurance companies; is that correct, sir?

The Chairman. Yes; long-term loans by life-insurance companies.

Mr. Whipple. To address myself to that part of the question: I would say that in part small business can expect to get some of its debt financing from the life-insurance companies.

As I testified here last week, Senator, the investment policy of insurance companies has been a rather dynamic one. I attempted to show the shift in the type and character of investment which had taken place over a 20-year period. Generally speaking the industry has been moving into the field of making investment in business—by "business" I mean general industry—and they have been spreading out into the smaller units.

Now, the question seems to be as to where the unit becomes so small that it is difficult, if not impossible, for the life-insurance company to furnish it with debt capital. There is a cost element involved and a loss element involved.

We have made, as previously testified, loans below $500,000, some below $200,000, but very few in that area. You recall the figures on that, Senator. We are moving in that direction. But whether or not we—I say "we," I am speaking of the Mutual, but I think it is true of the other companies as well; can supply the needs of small business as individual life-insurance companies is the question.

Since my return to New York we reopened our study, attempting to make more of our funds available to small business, and we think we can do so, but it is going to be a fairly costly job, and how much in the way of volume we can get of the acceptable type of debt is a question.

The Chairman. What are the elements of cost?

Mr. Whipple. The elements of cost are the acquisition cost, investigation, supervision after you make the investment; you would require more people and, of course, more expense, to go to various parts of the country to make that investigation; and then there is the loss element involved, that has not been absolutely fixed as yet.

Mr. Woodward, I think testified as to the studies being made on losses in investments by size, a week ago, and the indications seem to be that the losses increase as size decreases.

The Chairman. Have you looked into the possibility of local bank participation?

Mr. Whipple. We have been giving consideration to that, and I think any attempt on the part of insurance companies generally to broaden their activities in this field would have to be tied in with the local bank in some manner. Presumably the tie-in suggested by Mr. Lincoln in his testimony would be the best method of doing that.

The CHAIRMAN. One of the requirements suggested by Mr. Lincoln of such a participating plan was that the local bank should remain with the insurance company throughout the period of the long-term loan. That is to say, if there were a 10-year loan, so to speak, the local bank, no matter to what extent it might participate in the loan, would be expected to stay with the loan until the termination.

Mr. WHIPPLE. That is right, sir.

Mr. HERTER. May I ask a question there?

The CHAIRMAN. Yes.

Mr. HERTER. As I recall that particular testimony it came up in connection with loans of the magnitude of $5,000. In other words, quite small loans were being discussed at that time.

Mr. WHIPPLE. I didn't realize it was that small, Congressman Herter.

The CHAIRMAN. That discussion arose when it was pointed out that, on the schedule of the investments for 1948 presented by the Metropolitan, there was only one loan acquired during that year of less than $100,000, and that was in the amount, as I recall it, of $29,000.

So we aren't talking so much of the smaller loans, that is, in terms of $5,000, but in terms of loans, I would say, loans under $250,000.

Mr. HERTER. I don't care what figure we take, whether $5,000 or $25,000. Iet's say $25,000 is a small loan. Somebody has gone to the expense of examining that very carefully, and the entire business operation, before such a loan is made.

If the bank took only 10 percent of that, and passed over 90 percent of it to the insurance company, and the bank had to do all of the servicing on that loan, or do all of the watching of it, wouldn't it turn out to be a pretty unprofitable business for the bank itself, in retaining only 10 percent of the loan?

Mr. WHIPPLE. I should think it would, sir. Presumably the insurance company could pay some servicing fee to the bank out of its portion; so that, whatever that was, and applied to the smaller portion of the bank loan, there might be compensation. In any event I think it would be an expensive proposition when you are getting down that low.

The CHAIRMAN. I think the Congressman is quite right, that a 10 percent participation in a small loan would not attract local banking interests at all. But I don't believe that the proposal was meant to limit bank participation to 10 percent. Was it Mr. Madden?

Mr. MADDEN. It was rather an expression of an objective which would have to be tested out to find out just what the real answers are. You recollect, Mr. Chairman, in the process of discussion Mr. Lincoln was exploring with you the small-loan field and what could be done. Previously he had brought out in his testimony that there are life-insurance company loans to small business firms through mortgages. Further, many policy loans are going for small-business purposes. Then the question arose about making security loans to these small businesses, and probably using some of the same mechanisms. Apropos to that Mr. Lincoln said, maybe we could go ahead and make arrangements with local banks whereby the local bank would take a participation, say 10 percent, and stay with the loan, and we would provide the 90 percent. Mr. Hagerty previously had brought out the fact that these small loans necessarily are local loans; they have got to be. That is the background, as I understood it.

The Chairman. You are quite right.

Mr. Hopkinson. Mr. Chairman, are interpolations acceptable?

The Chairman. Yes, indeed.

Mr. Hopkinson. I think there are two precedents for what these gentlemen are discussing. The association between the local bank and the metropolitan, let's say, insurance company—I am using "metropolitan" in the sense of the big city, not a particular company—is really comparable to the relationship between the Export-Import Bank and the exporter of commodities or manufactured goods to foreign countries, where the Export-Import Bank takes a share of the risk and stays with it on a pro rata basis. The service fee is a normal arrangement and I think is comparable to the fees charged the members of the syndicate. That is just what you are talking about, I think.

Mr. Madden. Actually service fees are paid now in the mortgage field. In Mutual you pay a service fee?

Mr. Whipple. Yes; we pay a service fee.

The Chairman. Have you gone far enough into this matter, gentlemen, have you had experience with this matter sufficient to enable you to express an opinion as to whether or not local banks would be free to go into the long-term loans on a broad front, so to speak?

Mr. Hopkinson. Not in long-term loans; banks won't go into long-term loans. I think the Chairman of the Federal Reserve, in his statement last August to the Banking and Currency Committee, covered that situation very nicely in the prepared statement which he made at that time, wherein he pointed out that if business, whether small or big, made loans that required regular amortization, it resulted in their having to retain earnings to meet that amortization after taxes.

Mr. Whipple. To answer your question, Senator, I don't think we have had an expression from the banks as yet as to the extent to which they would participate in this kind of a plan. Certainly they would participate to some extent, we know, but how far they would go, particularly having in mind the individual bank, would depend, to some extent, on how many loans they might have of that character.

Furthermore, in connection with Mr. Hopkinson's statement, many of these smaller loans, of the type you are speaking, I should think might not be 10 years, but 3 or 5 years, in which case the bank, presumably, would be more likely to go along. Again, if there were 10 loans in one area it might be that the bank would feel it could only do 5—you see what I mean—on a balanced portfolio of this type of loan as against their normal current lending practice. It is too new an idea to evaluate the extent, at least in my opinion, the extent to which the banks would go.

Mr. Hopkinson. What you mean is that it is a semifrozen situation?

Mr. Whipple. That is right. I mean this type of loan.

Mr. Hopkinson. Yes.

Mr. Whipple. That is right. Depending on what else they had in their portfolio, to a large extent, and the amount that came to them.

Mr. MADDEN. Many of these questions will be answered after we have had a little experience, with this idea that Mr. Lincoln discussed.

The CHAIRMAN. You haven't been able to pursue the matter at such length as yet to express an opinion?

Mr. MADDEN. It will take time to do that. As time unfolds the actual facts and the actual problems and how they can be met, then the men of our company will be able to say how these loans can be handled. I know that as soon as Mr. Lincoln got home he went to work on this matter.

The CHAIRMAN. I know he did. I have had two letters from him, at least, and I think I have written him two letters on the matter since that time.

You were writing a question, Mr. Scoll, as though you had something to say on that.

Mr. SCOLL. Mr. Madden has practically answered the question. I was going to observe also that if we assume the worst, and, let us say, find out that the efforts on the part of the insurance companies to set up a mechanism for dealing with small and intermediate business requirements within their existing operations should prove to be disappointing, this committee would find itself faced with the necessity of dealing with the problem in some other way.

The Small Business Advisory Committee of Congress appeared here the first day of these current hearings and recommended that the Federal Government undertake a program of providing insurance for bank loans to business. I think that it might be a good plan to have some comments from you gentlemen on that proposition.

Dr. Kaplan, are you familiar with that plan, the proposal for a Federal business loan insurance program?

Mr. KAPLAN. I haven't seen the Commerce proposal recently. The last version I saw was at least 2 years ago.

Mr. KELLY. At that time it was a guarantee idea rather than insurance.

The plan now, Mr. Scoll, as presented by the committee was that an insurance fund be developed by the banks themselves, by means of depositing a portion of the interest charged with a management organization within the Government, and that the insurance fund developed by that portion of interest on the loan would accrue to the credit of the bank making the loan, eventually to become a self-supporting insurance fund back of the loans made by each bank.

The CHAIRMAN. You say it would be deposited with some agency within the Government?

Mr. KELLY. To manage the insurance fund, but the fund would be derived from the actual interest paid by the borrower through the bank, and would not be developed through any appropriated funds of Government. The only function which the Government would have, under the proposed plan, would be simply to manage the insurance fund, and in case of loss to review the discretion which had been exercised by the local bank at the time the loan was made, to determine whether it had met all of the legal requirements of a prudent loan. If it had, then the insurance fund would pay the loss.

Mr. HERTER. Through taxation?

Mr. KELLY. No; through the fund created and deposited with the Government.

Mr. HERTER. Why does the Government come into the picture?

Mr. KELLY. Only to have a centralized comptroller of the insurance fund, Mr. Herter; similar to the title-I loans of the Federal Housing Administration. It follows exactly the pattern of the title I loan.

Mr. HOPKINSON. Except in the nature of the risk involved.

Mr. KELLY. That is correct.

Mr. HOPKINSON. My judgment is that, from the standpoint of the borrower, he is the man we are concerned with, he is the one who is the enterpriser, if his business needs an insured loan he needs equity capital, and not to borrow money.

Mr. KELLY. I think on that score there is evidence that the average small-business man, I am talking about the fellow who wants to borrow from five to ten to twenty thousand dollars, not large money as Mr. Whipple was talking about, his tendency is to desire a long-term loan that he can pay back out of earnings, rather than to share his ownership through a stock proposition.

Mr. HOPKINSON. That is often what he desires, but I am not sure it is the best thing for him.

The CHAIRMAN. Let me for the record welcome Senator Flanders to the round table.

I was about, a moment ago, to ask, if it is agreed that business, small business particularly, does have a need of an avenue for obtaining loans from the savings of the people?

Mr. Hopkins tells us that if a business needs an insured loan it needs equity capital rather than a loan, which is a pretty acute observation on that point.

Do any of the rest of you care to make a statement on that? Mr. Koch?

Mr. KOCH. It seems to me you do run into this dilemma when you study the problem, that the average small-business man wants debt, he doesn't want to relinquish control of his business. But from an outside point of view it very often appears that what he should have is equity capital. I don't think you will ever resolve that difference.

The CHAIRMAN. Mr. Moore, you have a table which we asked the RFC to provide with respect to the record of RFC loans, as to their term. What is that statement?

Mr. MOORE. We sought this to throw light upon the type of loan request that is being put up to the RFC, to determine as to whether it is for long-term capital, on the average, or whether it is more typically what might be called banking capital, that is, of 90 days, or short term. The indication from this table on business loans and commitments recently outstanding, is that the period advances are outstanding is probably of the order of 3 years or 3½ years at least in the postwar period.

It shows that of 5,112 loans, for which authorizations were outstanding at the end of September, all but some 700 were made in the last 3 years. That would mean that some 4,400 of the loans are less than 3 years old. Moneywise these include substantially all. The residue that are older, are probably exceptional or problem-case loans.

The CHAIRMAN. With what year does that table begin?

Mr. MOORE. 1935. There is one 1935 loan outstanding for $250,000.

The CHAIRMAN. So that as of 1945 there was only one 10-year loan?

Mr. MOORE. That is correct. Taking those that date prior to 1939, that is, those of 10 years or more, there are 16 loans; there are only 24 loans that are 5 years or more old.

The CHAIRMAN. That is pretty persuasive evidence with respect to what the RFC has been doing. Suppose we insert the table in the record at this point.

Mr. MOORE. The loans appear to be neither banker loans nor long-term loans; they are intermediate credits of the 3 or 3½-year order.

(The tables above referred to are as follows:)

RECONSTRUCTION FINANCE CORPORATION

Aging of direct business loans and commitments outstanding Sept. 30, 1949

Calendar year authorized	Number authorized	Amount authorized	Calendar year authorized	Number authorized	Amount authorized
1935	1	$250,000	1944	6	$469,500
1936	6	1,660,000	1945	56	117,060,071
1937	3	40,000	1946	757	32,908,435
1938	3	615,000	1947	1,105	60,243,445
1939	3	180,000	1948	1,212	107,182,973
1940	1	250,000	1949	1,958	276,368,303
1941	1	850,000			
1942			Total	5,112	598,077,727
1943					

NOTE.—The amounts shown above are the original authorized amounts of loans and undisbursed commitments outstanding at Sept. 30, 1949, and have not been reduced by partial repayments or partial cancellations.

Aging of business loans and commitments outstanding (including participations in bank loans), Sept. 30, 1949

Calendar year authorized	Number authorized	Amount authorized	
		Gross	RFC share
1935	1	$250,000	$250,000
1936	6	1,660,000	1,660,000
1937	3	40,000	40,000
1938	3	615,000	615,000
1939	4	380,000	280,000
1940	1	250,000	250,000
1941	2	2,250,000	2,125,000
1942	1	35,000	35,000
1943			
1944	9	605,000	574,625
1945	320	143,061,626	136,586,995
1946	3,719	192,759,857	149,805,285
1947	3,607	182,505,807	147,907,182
1948	2,288	170,674,313	154,536,511
1949	2,911	422,842,797	372,985,246
Total	12,875	1,117,929,400	967,650,844

NOTE.—The amounts shown above are the original authorized amounts of loans and undisbursed commitments outstanding at Sept. 30, 1949, and have not been reduced by partial repayments or partial cancellations.

The CHAIRMAN. Dr. Kaplan, do you care to make any comment here with respect to the remark that small business needs equity capital rather than loans?

Mr. KAPLAN. I certainly think, in line with the statement presented to the committee some months ago, that small business needs both long-term credit for capital purposes and strictly equity ownership capital. This has need for both of them. If I had to make a choice between them, in terms of priority, I would say that the country's need is to, primarily, supply equity capital.

On the other hand, I think we have reached a stage now where probably more and more of the capital that we want to see converted into small busines equity will have to be of a credit nature. I think that we almost have to invent some kind of an intermediate type of investment which is equity and credit at the same time. I suggest to the committee that perhaps if we get a capital bank that is willing to share the risks with a small business by taking its common stock or taking the equivalent of risk ownership, that in order to make for the thing we want so much in small business, namely, the retention of the management of the small business by the small businessman, that there ought to be redemption features in the acquisition of the common stock by the fund-giving agency. If a small businessman feels that he ought to retain the management, and that is what he wants, he has a chance to prove that, in the course of a certain number of years, by being able to buy back his stock.

Mr. Herter. May I ask a question?

The Chairman. Yes.

Mr. Herter. In connection with any redemption feature, you are dealing with a high degree of risk, obviously, in this operation. Presumably the risks, the bad risks, are compensated for by the capital accretions of the good risks. In a compensating provision how would you take account of that? Would the initial issuer of that common stock be allowed to buy at the par value of the stock at the time it was taken over?

Mr. Kaplan. I don't believe that that would be at all fair. The financier, or the financing agency, must certainly be allowed to share in the gains as well as in the losses, and those, I would think, are capital gains as well as profit gains.

Now, I would like to conceive of a capital banking system, particularly if it were operated with an eye to our common civic purpose, and possibly under certain rules of the Federal Reserve System, that it would not take the full, what the traffic would bear out of capital values, that there might be some formula that would bear some relation of capital values to earnings over a period.

Mr. Herter. I was just wondering whether you had worked out, in your mind, any kind of a formula.

Mr. Kaplan. You would have to give the financier the benefits of reward of the sweet ventures in order to overcome what will undoubtedly be a considerable number of sour ventures.

Mr. Herter. If a man retains an option to buy back his stock, that formula has got to be worked out in advance; doesn't it?

Mr. Kaplan. It seems to me that that needs to be worked out in advance.

Mr. Herter. I just wondered whether you had thought that through from the point of view of what you considered to be a reasonable formula.

Mr. Kaplan. No, I haven't thought it through. I know that one of the things that has impressed me about the arrangements made by the two British venture capital banks, that I have been watching with great interest, is the fact that they apply a formula to each individual case. They have in back of their mind perhaps 8 or 10 stock types, but they make the application to the individual case.

Mr. Herter. And they have complete discretion; have they?

Mr. Kaplan. They have complete discretion except for the fact that one does have, as its court of appeals, the Bank of Canada, and the other has a sort of grouping of the Scottish and British banks.

Mr. Hopkinson. Mr. Chairman, I don't think Dr. Kaplan was here and had the benefit of the discussion this morning with regard to management stock. Some of the things he is proposing with regard to retaining control, with the financial venture being in other hands, comes close to what you described as one of the abuses of the twenties; it is not a modern practice.

The Chairman. To the extent that it is not a modern practice, why, we have a definite improvement.

We have before us at the moment what appears to be a suggestion of the Small Business Advisory Group, not of the Department of Commerce: an insurance system which would be managed by some Government agency but the funds of which would come from private individuals and organizations, by which loans would be insured; and we have Dr. Kaplan's suggestion, which is rather a private institution by which capital investment would be insured.

Mr. Kaplan. I have said nothing, Mr. Chairman, about insurance. My attitude toward it has been negative right along.

The Chairman. Merely that it would be supplied. You do not favor the insurance approach.

Mr. Kaplan. I do not, Senator, because I have been unable to see where this situation is comparable to the insurable type of risk. The very people who are to be the beneficiaries are the people whose own judgment is to be exercised in deciding what kind of loans they are willing to make and the more careless they are, the better they are going to fare out of the insurance. I just don't see what is insurable there. You don't have a law of large numbers applying to a type of situation, like the rate at which people will die, or the rate at which something that is pretty general will come in. In your Federal Deposit Insurance every hundred dollars of deposit is a hundred dollars of deposit. There are certain uniformities in the situation. Here you don't have innocent bystanders as beneficiaries. They are the very people who are exercising the judgment with respect to which you want them to become beneficiaries. So that, frankly, I don't see enough parallel between that kind of situation and the insurable situation to look upon it as an insurable risk.

Mr. Hopkinson. I would like, Mr. Chairman, to thoroughly join Dr. Kaplan in that statement. This matter was very carefully considered in connection with foreign trade. I think the unanimous decision of the National Advisory Council, Department of Commerce, State Department, Treasury, was that they would not make any proposal to Congress regarding foreign trade that went beyond possibly war risk and convertibility of exchange; but to insure the investment itself was just not an insurable function.

The Chairman. How do you view the capital bank idea as outlined by Dr. Kaplan?

Mr. Hopkinson. I think, if you will accept it as a very hasty impression, because I only received a full copy of Dr. Kaplan's report before lunch today, I am tremendously interested in his analysis of the problem, and his conclusion of certain ways that it should not be handled. I have just two or three opinions which I would like to put in. I question whether "capital bank" is the appropriate name. I would think possibly capital fund or some other title that doesn't so emphasize the debtor-creditor relationship. I also have lived through a good many reorganizations of public utility holding companies and have great reservation about putting out debt security secured by the equities of business. This was one of the things which led to many of the problems that we have been living with through the SEC. But I think in essence, perhaps to give the national banks, and I don't know whether the Federal Reserve bank, as such, needs participate in it, the right to use part of the stockholders' surplus for investment in such institution as Dr. Kaplan suggests, which is the only phase that, preliminarily, I see would require Federal legislation, might be a constructive approach—to let the management of a national bank use part of its stockholders' money to promote the equity which is essential to the safety of their debt investment.

I think that is the only comment I care to make at this stage regarding that.

The Chairman. Dr. Kaplan?

Mr. Kaplan. Mr. Chairman, I wonder if Mr. Hopkinson is referring to something which is equivalent of the suggestion that the capital of this thing that I have called the capital bank, but which you may call anything you wish, is to be subscribed for out of a certain percentage, possibly up to 3 percent of the capital of the national banks who happen to be in the district.

Mr. Hopkinson. I would rather relate it to the stockholders' surplus of the national banks than to their capital.

Mr. Kaplan. I am sure that if a group got together on the issue of what is the best method of subscription that it would work out something better than the tentative suggestion that I have made. I did indicate that while I thought of the members of the Federal Reserve as being those who would most naturally get into the subscription, because of the fact that it is a place of referral for their own clients, their depositors, for those cases which they, as commercial banks, cannot take care of, I didn't see any objection to others coming in as subscribers, whether they are finance companies or insurance companies or any other groups of that sort. I think the legislation should be permissive.

I was thinking, when I suggested that the Federal Reserve System watch it, that we must not get into the kind of a situation that we got into when we had a free-for-all with bank affiliates in the period after World War I. I know that deposits are an all-too-important consideration of commercial banks to allow the free and easy mixed banking that was typical of the nineteenth century, and a wonderful thing, but I don't think we can ever revive it, under the present conditions, and I don't think you can revive the British type investment trust, which did the same sort of thing.

I think we will have to have some stricter rules. I think we will have to put it under some phase of the Federal Reserve, and I am suggesting the Federal Reserve System as being the natural one if you have commercial banks doing the subscription; but at the same time I think—and on this point I have rather definite views—that the whole psychology of attacking the finance requirements of national business must be quite different from the psychology that a commercial bank necessarily applies to it. I just don't see mere guaranty, going along with the commercial bank, taking care of this problem, because I think you have to nurse along the small business; it must have as part of its own fixed servicee charges some of the continuing management, oversight, and counseling that it gets, and unless you combine the giving of funds with the watching over it, the review of the situation all the way through, you are not going to make a success of this thing.

Small business is a gamble. It has to be made a more scientific gamble.

Mr. HOPKINSON. Mr. Chairman, at the risk of talking too much, I will make one final observation.

The CHAIRMAN. It won't be final. We will ask you for others.

Mr. SCOLL. Before you do so, Mr. Hopkinson, I wonder if you and Dr. Kaplan got together on a point which was mentioned with respect to the issuing of debentures on top of earnings, equity earnings. I think you probably were referring, were you not, to the suggestion that the capital bank would be permitted to place its debentures, or rediscount its paper, with the Federal Reserve bank; is that correct?

Mr. HOPKINSON. Yes.

Mr. SCOLL. Did you get that point, Mr. Kaplan? I think Mr. Hopkinson was, in his criticism, criticizing one particular point, where he mentioned the evil of issuing debt paper on equity earnings, and he referred to the suggestion which was made in your paper that the fund, or the capital bank, be permitted to place its debentures, or rediscount its paper, with the Federal Reserve bank.

Mr. KAPLAN. I didn't realize those were the terms in which the question was put.

My feeling there was that, just as your British type investment trust had not only its own common stock, but had junior debentures which provided the underlying funds, that went two or three times, or more, in size, over the smaller common-stock fund, that I would give, and I said, "eventually," in my statement I would give to this group, as it developed in its experience, and the need for the additional funds developed, the opportunity to place its own debentures, backed by whatever it has. It will have some debt paper and certificates, it will have earnings that are coming in, it will have some accounts receivable, it will have some bills receivable, it will have many kinds of assets, so that its pool of assets ought to be capable of being pledged against additional funds for which it would issue debentures.

Mr. HOPKINSON. That is what the SEC has spent the last 5 or 6 years in doing, to get rid of the leverage situation.

Mr. KAPLAN. That is a part of the banking system in which, it seems to me, you have a type of oversight that is rather different from the sort of thing that was engaged in by the banking affiliates after the twenties. You offer a warning, which I think is proper, that the rules of the game that are applied must avoid the opportunity for excess that could lie in this situation.

Mr. HOPKINSON. You may be able to safeguard it.

The other observation I was going to make, and then I hope I am through, was that no matter who puts up the money, that doesn't invalidate what we were discussing yesterday, and this morning, that you have got to have the incentive for anybody to put up equity capital.

The CHAIRMAN. I think you are right.

Mr. Smith?

Mr. SMITH. Dr. Kaplan, I have two questions, and my second will depend on the answer to the first.

Is it my understanding that these loans or grants will be handled by the personnel of the present commercial banks?

Mr. KAPLAN. No, sir. The idea is to set up one or more, as many as there are localities proper for it, or needed for it, one or more district units of a district capital bank, or a district capital fund association, or what have you, which will develop a personnel entirely its own, a personnel of investment and finance people. I don't know that it will find its personnel within the commercial banking system—unless you get some of the type of country lawyers who have always stretched what the bank examiners have been willing to let them do—and I think you will find some talent of the kind you need possibly among the finance companies; you will find it among some individuals who have themselves been little investment trusts and know a proposition when they see one, and I think that personnel will have to develop through experience and develop a different type of technique from that which governs the average commercial bank.

Mr. SMITH. The reason I asked the question was because of one sentence that you have in your statement which reads:

> The capital bank that serves small business must not be inhibited by orthodox banking traditions.

That you have just brought out. As I read this I was wondering how the personnel could be obtained within a few years to have the know-how to do this.

Mr. HOPKINSON. Maybe, Mr. Smith, they will have to turn to the investment banker.

The CHAIRMAN. Mr. Hopkinson, may I ask you if your objection just expressed to this suggestion, or your understanding of the suggestion, was principally that it would revive the possibility of the pyramiding which was found so objectionable and which brought about the enactment of the Securities and Exchange Act, after there had been terrific exploitation of the investing public?

Mr. HOPKINSON. That is right, sir. I don't think it goes to the fundamentals of Dr. Kaplan's scheme. It merely goes to how much you can pyramid it on the initial capital that you are willing to put in it.

The CHAIRMAN. That is precisely what I wanted to develop. Is it necessary to permit pyramiding, in the exact meaning of that phrase; do you think pyramiding is necessary?

Mr. KAPLAN. In the first place, the pyramiding wasn't in the small business field that we are talking about.

The CHAIRMAN. That is right.

Mr. KAPLAN. I am thinking in terms of possibly a half-million-dollar limitation on any loan, or even if it were a million dollars it wouldn't begin to touch the pyramiding problem. In the second place, I don't think there is any possibility here of using one client as against another and building up client groups. It seems to me that those will have to be kept separate as individual situations, in which no client has to get mixed up in the risks of another client. It is part of the business of making the rules of the game. I don't see the necessity for pyramiding in this type of plan.

The CHAIRMAN. How much pyramiding would be essential under your plan, if any?

Mr. KAPLAN. I don't see that any pyramiding would be necessary. I thought Mr. Hopkinson's words of caution very proper, with respect to the possibility of the capital bank getting more and more additional funds from more and more business out of hypothecating the equities that it already has. As a matter of fact, I was thinking of only one step there, that it would take the equities that it has and rediscount them once, as a bank would do with the Federal Reserve System, and that it would stop there.

Mr. HOPKINSON. I don't think you can rediscount an equity.

Mr. KAPLAN. It certainly is a peculiar expression, I grant you that, but I still don't see that it is at all impossible. We have talked about common stocks as being the last stretching of the type of equities in which the capital bank could participate, but it would also have preferred stocks, it could have bonds, it would have 10-year certificates, it would have accounts receivable, it would have warehouse receipts—it would have whatever is needed, along with the character and management possibilities of the business, as assets. To make a package of that kind that is rediscountable does call for some different word, perhaps, from the word "discount" that I have used.

Mr. HOPKINSON. Even the SEC, Dr. Kaplan, permits more than one class of securities of a holding company where the underlying assets don't have debt. Their limitation relates to companies that have debt and preferred stock under subsidiaries.

The CHAIRMAN. Mr. Smith?

Mr. SMITH. I wanted to ask Dr. Kaplan if it would be his intention that there should be limitation to the ratio between the actual equity and the amount loaned.

Mr. KAPLAN. Amount loaned by whom?

Mr. SMITH. By the——

Mr. KAPLAN. By the bank to the client?

Mr. SMITH. Yes.

Mr. KAPLAN. My feeling about that would be that there should be no limitations at all of that type. If a man comes in with a patent, and you have to build management and marketing opportunities, and other things about the patent, there may be nothing in the way of equities to start with. Now, that would ordinarily be an unsound situation. I believe in venturers putting in everything, down to their last shirt, in the business, if you are going to back them. I am all for that. I can conceive of situations in which the amount of tangible equity put in by the venturer would be by far the smallest part of what it is that makes for a promising new venture.

Mr. SMITH. Then it would be possible to have a similar situation to the one we have recently seen in the RFC loan to Lustron?

Mr. KAPLAN. There is that possibility. I think we are trying to develop a type of financing to take care of very volatile and very risky areas of our economy, but an essential one, without which it is hard to conceive the continuance of a real private-enterprise system, and I don't think that we should blink the fact that a great deal of liberty must be given to an agency of that sort if it is going to come out on top. If you hold it down to the kind of investments that an insurance company has been allowed to make directly, you are not going to take care of the small-business problem.

The Chairman. Let me interject at this point, please, that during the testimony of the representatives of the insurance companies, we had, for example, Mr. Clarke of the Occidental, from California, a subsidiary of Transamerica, who spoke with complete approval of the California law that permits investment up to a certain limitation of insurance funds in common stocks; we had testimony from some of the other representatives of the insurance companies suggesting that the question of investment in common stock should be studied—I think, Mr. Whipple, you made some reference to that?

Mr. Whipple. That is right, sir.

The Chairman. The question that is running through my mind now is whether, in your opinion, bearing in mind what Mr. Hopkinson said a moment ago about capital not being the base for these investments, but surplus rather, what would you have to say about the possibility of the surplus of insurance companies being made available for the acquisition of stocks, in such a fund as Dr. Kaplan has discussed?

Mr. Whipple. That would require legislation.

The Chairman. Yes.

Mr. Whipple. Special legislation. Presumably it should be tied in to some percentage of the surplus reserve of the insurance companies, I would think.

Mr. Herter. No Federal legislation can override the State on that subject.

Mr. Whipple. That is right.

Mr. Herter. It would have to be done State by State.

Mr. Whipple. Yes.

The Chairman. Of course. But inasmuch as there was a suggestion with respect to surpluses, I wondered if Mr. Whipple could express an opinion.

Mr. Whipple. It might take the form, in the case of insurance companies, Senator, of some percentage of assets, rather than surplus, because, you see, our surplus is limited by law to 10 percent of our reserves, so we cannot build the same surpluses that commercial banks are permitted to build with their capital funds, and have a limitation on an investment, this type of investment for insurance companies, based upon a percentage of assets.

For example, in the sale and lease-back which we discussed last week, the New York law provides that 3 percent of admitted assets can be invested in that type of investment. I should imagine it would take the form of a relation to admitted assets rather than to surplus.

Mr. Hopkinson. I think you have to draw a distinction between the mutual companies and the stock companies, because in the stock company you have a stockholder surplus as well as a policyholder reserve.

The Chairman. Yes.

Mr. Hopkinson. And here, this surplus that we are talking about, is really a surplus that belongs to the mutual policyholders.

The Chairman. Yes; you are quite right about that.

Mr. Kelly. Senator, may I speak to Dr. Kaplan's proposition for just a moment, please?

Understand that I am not speaking for the Department of Commerce, but in the absence of the Small Business Advisory Committee, I am endeavoring to express their opinions.

The CHAIRMAN. That is understood.

Mr. KELLY. Mr. Bimson, who presented this general idea of insured loan, is a banker himself, from Phoenix. Their idea, Mr. Kaplan, was that the capital bank idea addresses itself primarily to the purchase of stock, the stock of the company, although you mentioned the power also of purchase of debt paper, but primarily the stock of the company. It should be recognized, I think, at the outset, that only about 15 percent of all the business enterprises in the United States today are incorporated—and that includes all the big ones. So the volume of small businesses about which we are talking, that have stock to sell, is extremely small. Then if you start to talk about debt paper, we see no reason why our present banking system isn't adequate, and we advocate the present banking system to take care of that feature of providing capital, aside from the purchase of equities or stock.

The committee believes that with proper assurance, or insurance, back of the local bank, that you will have quite adequate supervision of the loan, that you will have local understanding and appreciation of the needs and developments of the industry, and that your local bank, with that sort of background, based on the experience of the title I, would be the most advantageous method of meeting the type of funding that small business apparently needs.

In the report here that Mr. Moore presented, from the RFC, there is indicated that most businesses that are appealing to RFC are not seeking long-term loans, which would be the kind of money they would want if they wanted to sell equity, but are looking for shorter-term loans—which they are endeavoring to secure—and which they hope to pay back out of earnings and retain their ownership.

So, therefore, the Small Business Committee has urged the continuance of the present function of the local banking institution without injecting anything new, without injecting any new organization, without injecting the Government, in any sense, except as a manager of the insurance fund. We look to the local bank to handle the needs of small business on a strictly local basis and on a loan basis.

The CHAIRMAN. How do you meet Mr. Hopkinson's observation that such situation demands equity capital rather than loan, insured loan?

Mr. KELLY. Well, the only thing I would have to say, Mr. Hopkinson, is that it is rather obvious that the small-business man, and, mind you, we are talking about the small-business man, while you may say that equity capital is what he should have, it isn't what he wants, and it isn't what he is seeking, and his need for money is not for a long enough period to justify his going through incorporation process in order to develop equity for sale, and if he did the cost of selling small issues is so exorbitant that it is almost prohibitive in the sale of stock on the market, if he can, indeed, find a market.

Mr. KAPLAN. It appears to me, Mr. Chairman, that some response to Mr. Kelly's comments is called for.

In the first place, with reference to the idea that only 15 percent of all businesses are incorporated, that can give a very distorted picture. It is easy enough to say, and it happens to be a fact, that out of nearly 4,000,000 businesses in this country, nearly 2,000,000 have no employees at all. The great majority of them are people who will work for you as a carpenter, if you are a contractor and have a job for them. If you don't have it they will go back and be their own little contractor, and they will do the same with regard to peddling goods for themselves as against selling it for a firm. Those people, in terms of numbers, constitute the large number. I am not at all certain that the great problem of small business is to take care of these people who can operate on their tiny shoestring, or who, even though they don't have any employees, operate a continuous operation, whether it is a store or a little shop, taking care of themselves pretty well.

When you say 15 percent you have to include all of those in order to get that percentage in. Let's clear that out of the way and recognize that the core of this problem, whether it is a partnership or a corporation, represents some addition to employement in this country, or is going to, and gage the need, the money, at the point where it gets out from the "no employee" status to something else that needs taking care of, and the whole universe that we have in mind isn't going to be the nearly 4,000,000 businesses. It is a core of three to four hundred thousand that are the heart of the business vitality from which you are going to get the kind of competition that big business needs, as well as small business, small business vitality, and at that point it is a matter of indifference, for a time, whether it is incorporated or not incorporated.

There are ways of getting at the assets of the organization, whether the assets are in terms of common stocks or in some other form. Finance companies have no trouble with the question of whether they are financing a corporation or noncorporation. So that I don't think that that is a bâsic problem, this matter of whether it is incorporated or not. I want to point out that a capital bank of this sort must be relieved of the kind of rules that would apply to a public issue with the SEC. All of these expenses have to be eliminated if you have a capital bank that operates responsibly under the Federal Reserve System. It has certain sanctions that make it unnecessary for any of its operations, whether they are credit operations or indirect equity investing operations, to require the sort of thing that you have to go through with the SEC.

Finally, I go back to the point that this isn't a complaint against the commercial banks. Commercial banking does not operate in the greater part of the sphere that represents the gap. The gap is in equity capital or such additions to working capital as must eventually get into equity. It is a permanent, more permanent type of capital that has to be converted into equity. Whether you offer it as loans to begin with, or whether you offer it as direct investment, it is the kind of capital in which the financier directly shares in the risks with the client. That is not deposit commercial banking as we understand it today. It is a different type of function.

I don't think that we will get very far if the commercial banker looks upon it as some sort of a criticism of the way he is operating. I think that with the rules under which commercial banking operates, some of them legislative rules, some of them rules of tradition that are just as powerful, that the gap is going to remain. We don't have a type of banking that takes care of participation in the ownership risks of small business, and without some funds becoming available for that, I don't see the percentage of small business in the total of our economy substantially rising.

The CHAIRMAN. It has been pointed out on numerous occasions during this hearing, both in the nature of direct statements and in the nature of necessary conclusions from statistical information, that we have a great change in the character of savings, that a multitude of people with small savings available for debt and not used for venture capital have taken the place of the large savings of the very wealthy, who in the past generation were the principal source of venture capital.

We have not as yet found a way to channel that multitude of small savings into the ownership of new and expanding small business. Have I stated the problem as you understand it, Mr. Hopkinson?

Mr. HOPKINSON. Admirably, sir.

The CHAIRMAN. The problem of this committee, therefore, is to decide what we can do about it. Insurance companies are struggling with the problem of providing debt capital by this bank-participation plan. The suggestion that was made by the small-business advisory group through Mr. Bimson when we opened our hearings a week ago Tuesday, as modified by the later presentation, as I understand it, and Dr. Kaplan's suggestion, are intended as methods of providing primarily equity capital, because the debt capital that you speak of, Dr. Kaplan, you want to mature eventually into equity capital; do you not?

Mr. KAPLAN. Yes; I think of it as permanent capital, whether it is now equity capital or not.

The CHAIRMAN. I would like again to invite the considered opinions of these experts from the financial world as to whether or not one or both of these proposals offers a basis for a recommendation that this committee could make. It may be that neither one of them will get your complete support, but does there appear to be the germ of a suggestion which could be developed?

Mr. SMITH. Perhaps I am going a little far back in digressing from your question, Mr. Senator. I was handicapped the same as Mr. Hopkinson in not seeing Dr. Kaplan's statement until after we had adjourned, but I have read some of it and it is most interesting.

I do not feel that with the short study I have made of it I would want to answer either yes or no to your question, but there is a question I want to raise. That is this: I wonder if there is a real problem or if it is not the age-old problem and a perfectly normal, natural desire on the part of a businessman to get money perhaps more rapidly than his experience or ability or time should justify. I do not know. I am just asking this to get back to whether there is a problem.

I wonder if it has not been exaggerted. I wonder, if possible, the success that farmers have had in coming to the Government perhaps has not whetted the appetite of the small-business man. I wonder if you were convinced——

The CHAIRMAN. May I interrupt at that point to say that when the farm bill was before the Senate—I will let Congressman Herter speak for the House—when the farm bill was before the Senate, there were only seven votes cast against it, sir.

Mr. SMITH. I read here and I would like to just quote it, if I might——

The CHAIRMAN. Says he, completely disregarding the interruption. [Laughter.]

Mr. SMITH. He says it is not possible from the available information to bring up reliable statistical measures of the extent to which deserving small-scale enterprises are being prevented from expanding through lack of adequate financing facilities. Then he goes on to say that the position can be taken that the market itself is the most practical judge and that if we do not have more facilities for financing small business, it is because we do not need more facilities or that there is not sufficient attractiveness in the given small business to justify further investments therein.

Have you, Doctor, made surveys that will satisfy you at the present time that the Nation is confronted with a real problem so far as lack of financing in small business is concerned?

Mr. KAPLAN. Well, I make some reference in the statement and in the manuscript that was prepared for the Committee for Economic Development a few years ago to some studies which were made that indicated the very, very thin base on which small business has to operate, even businesses that are already operating, indicating that they were never put in the kind of financial position where they could weather a depression. I referred to the McMillan study, and I referred to a number of group meetings that we had to have in connection with the preparation of the CED manuscript.

I made certain inferences from the capital structures that were shown in the studies that were made during the 1930's as to why so many businesses went on the rocks, certain inferences from the fact that even in the best prewar years like 1940 or even 1937, a boom year, that out of your corporations with assets under $50,000 something like 55 percent of them were deficit corporations even in the best year. In other years something like the figures Dr. Kreps mentioned were approached. All of which indicates that business has had to carry on despite the fact that the funds have not been available.

I have to admit that I do not have a definite positive statistical measurement of all of these cases. People do not go around shouting their failures to get these funds. We have had to get these things by inference. But in this country and in other countries the changes that have taken place are quite obvious. The opportunities to invest in blue chips, the pressure to buy Government bonds, all of the large sums that are being drained away from small venture capital by the other outlets that exist are so different from the situation 50 years ago that we have to reckon with the fact that the percentage of available funds is quite different today and we actually have to do something of a positive character to make up for this shrinking of the outlets relative to the total economy.

So you get a situation in which there are as many people wanting to go into business as ever before—on paper you see as many small businesses relative to the population as you ever saw before—but the capital structure relative to the total is shrinking all the time, the base is extremely thin, the commercial banks worry about having to make short loans to these small firms because they do not have the necessary capital base.

In the case of the British companies they claim that one of the best things they seem to have done for the commercial bank was to put some of their clients in the position where the commercial banks could really make loans to these clients because of their improved capital structure.

You add those factors together and you have a situation that I think is bound to convince reasonable people. I pointed to special studies such as that of the New England Council that studied this question intensively for New England, a study of failure cases over a great many years by Mr. Roy Foulke of Dun & Bradstreet, and it all comes together. There is no disunity on the part of those who have had occasion to study.

While, of course, I admit that I cannot hand you a table of all of these cases, I say the whole situation adds up to that. We do not have for small business a sound capital structure. The amazing thing is how well little-business men manage to hang on and even to make some money in the face of the fact that you do not have the kind of channels for them that you do have for larger enterprise.

Mr. Smith. My curiosity was further aroused in another part of your statement referring to the loans made by the RFC between the years 1932 and 1941. There were some $460,000,000 in loans made, some 5,100 loans made. But the total in amounts of $10,000 and under during that period amounted to only $21,000,000.

I was wondering why it was that so few—that, as I say, brought up the question whether we had a problem. I wonder, too, if before this committee resolves its findings as to whether something should be done or not, whether a really adequate survey—and I do not know who could probably make that better than the Brookings Institution on the whole problem——

Mr. Kaplan. Frankly, a survey of small business, with the numbers of different situations that are involved just baffles any individual or small group, and it has baffled the Department of Commerce, which has had better access to that sort of thing than almost anybody else. The small-business man and any commercial banker, particularly in urban areas, will tell you this, the small-business man can very seldom state his case for a loan even when he has a case for a loan.

What we are engaged in talking about here is not merely giving money to small-business men, but providing some channel to which the small-business man can come, or if he does not know about it, can be referred by his bank, that will go over his capital situation for him. There are a great many of these small-business men who do not know how sick their capital structure is until a depression hits them or until it is too late to do anything about them.

I keep emphasizing that the guidance aspects of this venture that we would like to see made on a broad civic basis, even if it involved governmental backing, in giving small business a channel through which it can place its proposition and its needs before the people who can help them, or a place to which the commercial bank can send this individual who needs to have his capital structure strengthened, where the commercial bank can see it and the individual does not see himself why it is that he cannot get a commercial loan is something bigger than merely deciding whether there are enough people who have been weeping on somebody's shoulder about not getting enough money.

We are trying to preserve a very important level, that small-business sector. We have to do something more than say to the small-business man, "You haven't shown us that the problem adds up to so much by your own efforts; therefore, the problem needn't exist and we needn't bother with it." I am sure you would not take that position or anybody else. I think we are at a stage now where some of the thinking on this whole program has to be done on a very broad base. You might find 50,000 small-business men who could come in to this committee and say, "We don't want any more new fellows in here; there are enough of them in already." They would much more gladly go into some barrier type of legislation, as many of them have done.

But the issue is bigger than what a few small-business men want. It is the issue of retaining within our system the small-business sector.

Mr. Smith. I do not think anybody can deny the value or the importance of the small-business man. As I say, I do not know whether he should have help or not. What I am trying to do is find out whether he needs it. I know, of course, that Government has had tremendous pressure put on by the small-business organizations, but I still do not know the answer to my question. I wonder if the committee would not want to take time enough to give further study as to whether there is a problem and go about a very objective and disinterested survey to find out whether there is any need for such legislation or such a proposal. It is very intriguing. I am very much intrigued with your proposals.

Mr. Herter. I wonder if I might interject something. In the determination of the need for something of that kind would not the willingness of the commercial bank to subscribe a portion of either their surplus or their capital to a thing of this kind show up pretty quickly whether or not they felt there was both a social need and an industrial need for that type of thing sufficiently large to warrant their making the subscription of that kind? You would not want to make it compulsory, would you, that they had to subscribe so much?

Mr. Kaplan. I certainly would prefer not to make it compulsory, but, frankly, I do not believe that the attitude of the commercial banks can be decisive in the determination of a situation of this sort. The commercial banks have opposed the practice of introduction of something that interfered with the commercial banking tradition, just as we all do in any field—academicians do the same sort of thing. They may look upon this as something that does compete.

Some of the very best commercial bankers in the West were opposed to all forms of special banks for agricultural loans and others of that sort, and it was usually the best bank that did the opposing because they were doing things you wished the other banks had done. I think that you must expect the commercial banks will frown upon the idea of something new getting into the picture. I do not think that is a decisive factor.

Mr. Kelly. Might it not be true that in an area where the risk was highest in supporting small business of the area that would be the very place where the banks would be most reluctant to participate in the capital bank idea?

Mr. Kaplan. I do not know whether you can even make a rule of that. I think of the way the Bank of America group on the west coast flouted commercial banking tradition to the point where presumably they are on the wrong side of the tracks with respect to a good many of the bankers there, and yet by taking those risks and mixing them up in very large numbers, they have been able to grow with the growth of that area.

I am sure that they had many, many sour loans and did a great many things that made the examiners look askance, but the average commercial banker who does what is considered sound commercial banking does not touch this problem that we are talking about.

Mr. KELLY. I think, Mr. Smith, you should read the table that you read a moment ago about the loans made, not with the idea that that is an indication of the need for loans, but that it is an indication of the loans which were actually made, where there may be a great gap between that and the applications for loans due to traditional restrictions on the making of loans. It is that marginal type of loan that we believe the small-business man needs. That is the area in which he needs some help, the marginal type, which probably never got to the stage of the loan.

Mr. SMITH. That is right.

Mr. HERTER. I wonder if Dr. Kaplan could develop more how this new bank would operate. Presumably it has to make an inspection of the business in some form or other and presumably not taking on every risk that comes to it. It must do a highly selective job, and in determining selectivity it has to determine about the businesses that come to it. There are certain credit policies. At that point, the question of whether an individual or corporation is credit worthy or not, really runs afoul of the ordinary banking operation. I am not at all clear at what point the normal commercial function no longer is applicable and at what point they determine to buy some of the common stocks or some preferred stock or make a loan on receivables, for instance. The latter is certainly an ordinary banking function, warehouse receipts or anything of that kind. That is a perfectly normal banking function.

Mr. KAPLAN. Yes; where you have collateral that is going to outlast the loan, the commercial bank will go up to even a maximum of 5 years. There have been situations of that sort, of course. But your commercial bank makes very few loans above 1 year; even during the lush years following the war the check-up of the Federal Reserve indicated that the percentage of these longer-term loans was not greater than it had been before the war, despite the fact that there had been great reforms of practices and a letting down of the bars on the part of Federal Reserve examiners, and so on. The commercial bank that makes the long-term loan does it as the exceptional thing. There are some cream-off-the-top loans that are very good and almost riskless loans for a longer period.

Finance companies pick up most of the lending on accounts receivable. Of course, those involve rates that they feel are necessary in order to do that kind of business, but the commercial bank is not primarily interested in reshaping the capital structure of a small business or in helping the small business to expand. The last thing on earth that the commercial bank wants to do is to get out of its role as a creditor who will find what there is in that situation, no matter how sick, that is negotiable and that is reducible to a liquid payment.

Now, that approach, it seems to me, is the natural approach of a bank of deposit. It is the very approach that does not give the small-business man his chance to get his capital structure built up for him so that he can go ahead to expand. At the same time, many a commercial banker is very sympathetic to the client for whom he cannot do what the banker as an individual might be very glad to do. It seems to me that at that point it is to the advantage of the commercial bank to be able to say, "We are now part of an organization to which we can refer you and have your capital situation gone over and let them see whether they can undertake in your behalf—whether you are a newcomer wanting to go into business or whether you are expanding—undertake in your behalf a type of risk-suring that I, as a commercial banker, simply cannot undertake."

Mr. Herter. Just recently we had this testimony from the Research and Development Corporation here in regard to the number of applications that they had had. They were doing somewhat the same type of thing that I imagine you visualize this bank doing.

As I recall it, the percentage of the organizations that they helped finance from an equity point of view was about one-tenth of one percent of those who made application.

Mr. Kaplan. I would say they represent a florist shop alongside of the Ritz on Fifth Avenue, and we are talking about Sears Roebuck. It is as far apart as that. There is an organization that has top-flight scientists and engineers and others available to take over something that can develop into a real new venture that is going to blaze a trail. They are not going to take the case of a group that know how to do something with metal belts, we will say, and want an opportunity to expand the belt business or the leather bag business, or something of that sort.

Mr. Herter. I am not sure. When you begin reading over the list—

Mr. Kaplan. The one in which Senator Flanders was one of the founders?

Mr. Herter. They had most extraordinary divergence, even going into the fisheries in the Fiji Islands and the shrimp canning operations in the Gulf area, and they were there picking up existing businesses, recapitalizing them.

The Chairman. And expanding them.

Mr. Herter. Yes.

Mr. Kaplan. I think that correction is necessary, that in recent years—and it has been a change from the original policy—in recent years they have gone into a few of those. But I still feel that it does not begin to tap the mass need or the mass market. It is a highly selective specialty agency and, as I indicated in my statement, the more of those we have the better, and they are all to the good. I have not decried your Industrial Development Corp., to which I devoted some attention, but it simply is not the run of the mill. The kind of people we are talking about would not know how to walk into the Industrial Development Corp.

Mr. Herter. I was thinking along the lines of the question asked a moment ago. Is there no way of developing a sort of "pilot plant" operation here to actually see what the need is and see how it might work out in practice and give it a few years to operate?

Mr. Kaplan. I believe in your own area there was a group that was hoping to set up a small business capital bank under private auspices as a starter.

Mr. Herter. I followed it very carefully during its organization and development and it had immeasurable troubles.

Mr. Kaplan. I would like to say this off the record.

(There was a discussion off the record.)

Mr. Kelly. I believe if Walter Bimson were here, he would say that, recognizing the fact that real-estate loans are more easily measurable than business loans, but with that qualification, we have 10 years' experience in the Housing Administration with the title I loan as evidence of the thawing out of credit which that measure created, that the likelihood of exactly the same pattern for loans to business would undoubtedly thaw out capital again just as that has done.

Mr. Herter. I question very seriously as to whether you have a comparable situation.

Mr. Kelly. You have to compromise the thing on the measurability and security aspect of a real-estate maintenance loan and strictly risk business capital.

The Chairman. Have you considered the demand which is constantly made of Congress for the expansion of so-called secondary markets by which the Government is asked to appropriate funds by which some of these real-estate mortgages are bought by the Government and taken off the hands of the local bank?

Mr. Kelly. Yes, I know.

Mr. Herter. I found in the last compilation of "Fanny May" (FNMA) that they did not have a single mortgage in a single New England State. They were very extraordinary figures they put out. They put out their holdings all over the country, and I think there were 12 in Connecticut and that was the total for all of New England.

The Chairman. In other words, New England is standing on its own feet.

Mr. Smith. Mr. Herter made a point a few minutes ago that I think could be develoned, speaking of the American Research & Development Corp. If I remember the figures in the testimony, there were 3,000 applications that were made, there were 1,500 deemed worthy enough to give a project number, and there were 16 that were granted. There would be a comparatively easy and short job, I would think, to analyze those 1,500 that were discarded, what merit they had.

Mr. Kelly called my attention to the fact, when I was reading these figures about the Federal Reserve, there was no mention made of what loans were rejected. There we have another source of knowledge right here in the city of Washington that might be very worth while going into to see why they were rejected, whether they had any worthiness to them, and what is the problem—two fairly easy things, I would think.

Mr. Moore. I do not believe you will ever get statistically satisfactory information as to the unfilled need. You can get something impressionistic or qualitative. I once directed a study involving the examination of thousands of loans rejected bv local bankers. As soon as one gets the data on applications and denials it becomes a question of judgment as to the wisdom of the bankers' having rejected it.

The Chairman. It depends upon the amount of flint in his eye.

Mr. Moore. Exactly. For instance, we had several people attempting to appraise identical cases. One would say the loan should have been made on the basis of all the evidence. On identical evidence another man with other biases or predilections would say it should not have been made. The point I wish to make is that the unsatisfied "need" for credit or capital is going to be a qualitative estimate. Impressionistically one may feel sure there is unfilled need, but statistical evidence on the amount will be so influenced by specific predilections that it will be useless.

Mr. SMITH. I realize pure statistics might not give the answer, but it might give some clues to go on, what I have been advocating, that maybe then a real survey, which would have to be done by interview, might point up: Have we got a problem or haven't we?

The CHAIRMAN. My recollection of the evidence with respect to the American Research & Development Corp. was not that 1,500 plans had been rejected, but that 1,500 plans were still on file and that here was a problem of selection with a necessarily limited amount of capital to go into the enterprises.

Mr. SMITH. I think 1,500 rejected and 1,500 given project numbers for further consideration but only 16 accepted.

The CHAIRMAN. I do not believe that even that answer involves the notion that the 1,500 which were rejected by American Research were without some degree of merit. But in any event, we have here the unquestioned testimony, which I think no one will deny, that we have, as Mr. Hopkinson said this morning, experienced a profound change in the distribution of the savings of the people and that the little people have the bulk.

At the same time, in the course of his statement he called attention to the increase of debt capital. His figures—I have them here—were given and his conclusion stated in this manner:

> In 1946 over 68 percent of all new corporate financing was by the use of debt securities. In 1947 it was over 76 percent and in 1948 over 84 percent. Most of these debt securities were purchased by insurance companies and other institutional buyers.

Now, there, I think, is a fact with which every observer will agree. It means that ownership is not spreading, it means that savings are going into debt instead of into ownership, and it seems to me if the private property system is to be maintained, it can be maintained only through expanding the area in which private savings can be invested in ownership, which, of course, is to say in equity.

Now, with respect to Government assistance to promote this objective, which I think everybody agrees is desirable, we are faced with the condition which develops in some of the loan systems that the Government now has. Of course, in the first place, we began with RFC, which was an effort to bail out losses when losses were incurred by private enterprise as a result of the crash. The RFC was an emergency response to an emergency condition, and yet RFC remains and is still loaning public funds on what the RFC believes to be good security, and it has made money at it, even though everybody who testifies here agrees that these are extraordinarily profitable days for business.

Now, when a proposal is made for Government assistance, whether by way of insurance or by way of loans, we come immediately face to face with the development which I mentioned a moment ago, that even bankers want to push off these loans on the Government after they have made the first transaction, and that puts Government in the position, to use the vernacular, of holding the bag, does it not?

The proposition made by Dr. Kaplan, however, eliminates Government from the picture and offers what seems to be a formula not yet perfected, of course, for enabling the private enterprise system itself to provide the equity capital which is essential to expand the private enterprise system.

Is that the way you look at it, Doctor?

Mr. KAPLAN. I think you have stated it very nicely.

The CHAIRMAN. Now, on the other hand, so far as loan capital is concerned, we have the insurance companies struggling with the problem of trying to make loans available to these little people of whom Mr. Hopkinson was speaking, whose savings are not being distributed to the little-business man. I do not know whether we have, so far as this afternoon is concerned, exhausted the possibilities of the roundtable. There does come a time when conversation does not produce anything more.

Mr. HERTER. I wonder if I might ask one further question and just toss it into the hopper.

The testimony of Mr. Hopkinson this morning dealt, as some of the previous testimony did, with various suggestions as to how equity financing could be made more attractive and also how you could get a larger fluidity, so to speak, in the present equity market.

I asked him if a large number of blue-chip stocks purchased by insurance companies or other institutional investors on a larger scale, would affect the entire market all the way along the line. Nearly all the suggestions made to the committee have to do with the present tax structure and the double taxation. If relief were given there, to what extent do you think there would be more money available all along the line for equity financing that might reflect itself down into the small-business level?

Mr. KAPLAN. I am sure small business would share in that greater availability. I would not question that at all. I still think, though, that the tempting opportunities that exist in negotiable equities that are traded in on the exchanges, coupled with the difficulties of flotation of the securities of the smaller companies, would give you that new money in about the same proportion as you have it now, although I am inclined to think that maybe small business would get a little better than the present share out of that additional money. I cannot say. I think it would help. I do not think it would solve the problem.

The CHAIRMAN. I wish you had been here this morning to hear my lecture on establishing standards of responsibility.

Mr. HERTER. I was here.

The CHAIRMAN. Oh, you were? I had forgotten.

Well, gentlemen, on behalf of the committee I want to express my most sincere appreciation for your participation in this presentation. Mr. Scoll remarked to me a little while ago that we began these hearings a week ago Tuesday with the testimony of the Small Business Advisory Council and we have traveled all around the circle and we have come back to the discussion of one of the suggestions of the Small Business Advisory Council. You have all contributed a great deal, I think, to our enlightenment upon this subject—certainly mine—and when these hearings are printed, I hope to the enlightenment of the public.

Thank you very much, gentlemen. The hearings are closed.

(Whereupon, at 4:10 p. m., the hearings were closed.)

APPENDIXES

Appendix A

Number of business firms in operation, Sept. 30, 1943 and 1948; number of new business established, 5 years, 1944 to 1948, inclusive, with relationships

[Numbers in thousands]

Industry classification	Businesses in operation			New businesses established, 1944 to 1948, inclusive	
	Number, Sept. 30—		Percent increase, 1943 to 1948	Number	As percent of beginning of period
	1943	1948			
Products of petroleum and coal	1.2	1.4	16.7	8.0	666.7
Lumber and timber basic-product manufacture	44.9	74.1	65.0	107.9	240.3
Contract construction	155.4	325.4	109.4	319.4	205.5
Miscellaneous repair service	47.4	105.0	121.5	93.0	196.2
Retail appliances and radios	11.5	27.2	136.5	21.7	188.7
Miscellaneous other manufacturing	14.2	24.4	71.8	23.4	164.8
Stone, clay, and glass products	7.3	12.0	64.4	11.4	156.2
Transportation equipment	4.1	6.6	61.0	6.2	151.2
Professional, scientific, and controlling instruments manufacturing	1.9	3.7	94.7	2.7	142.1
Electrical-machinery manufacturing	2.9	4.9	69.0	4.0	137.9
Transportation, communication, and other public utilities	117.8	188.7	60.2	144.9	123.0
Automobile-repair service	59.4	95.3	60.4	72.2	121.5
Rubber-product manufacturing	1.0	1.6	60.0	1.2	120.0
Business service	50.0	82.0	64.0	57.4	114.8
Retail motor vehicles	32.6	57.4	76.1	37.3	114.4
Metal and coal mining	12.5	14.2	13.6	13.6	108.8
Amusements other than motion pictures	41.5	54.9	32.3	42.4	102.2
Retail automotive parts and accessories	13.4	22.2	65.7	13.1	97.8
Leather and leather-product manufacturing	4.7	6.5	38.2	4.5	95.7
Apparel and other finished textile products, manufacturing	24.1	32.5	24.9	22.6	93.8
Manufacture, machinery except electrical	12.9	19.3	49.6	11.7	90.7
Retail lumber and building materials	25.8	38.4	48.8	22.1	85.7
Fabricated metals and metal products	11.8	18.0	52.5	10.0	84.7
Retail liquors	14.1	21.8	54.6	11.9	84.4
Textile and textile-product manufacturing	32.2	43.3	34.5	26.7	82.9
Wholesale trade	139.3	202.8	45.6	114.3	82.0
Retail home furnishings	28.5	42.9	50.5	23.3	81.8
Mining and quarrying	31.1	35.5	14.1	23.7	76.2
Furniture and finished lumber product manufacturing	7.8	11.0	41.0	5.9	75.6
Primary metal industries manufacturing	4.3	6.2	44.2	3.0	69.8
Retail eating and drinking places	271.7	324.3	19.4	186.4	68.6
Laundry, cleaning, and garment repair	86.4	114.5	32.5	58.6	67.8
Other personal services	76.9	99.0	28.7	48.1	62.5
Nonmetal mining and quarrying	4.0	4.4	10.0	2.5	62.5
Retail trade, all classifications	1,375.9	1,706.1	24.0	802.9	58.4
Retail, miscellaneous food	89.7	104.7	16.7	51.4	57.3
Filling stations	910.1	227.8	19.8	105.4	55.4
Retail hardware and farm implements	33.7	46.8	37.7	17.8	52.8
Petroleum and natural-gas production	14.6	16.9	15.8	7.5	51.4
Paper and allied products manufacture	3.7	4.2	13.5	1.9	51.4
Retail apparel and accessories	78.9	97.2	23.2	39.1	49.5
Barber and beauty-shop service	191.7	214.1	11.7	91.9	47.9
Textile-mill products manufacture	8.1	10.7	32.1	3.8	46.9
Chemical and allied products manufacturing	10.3	10.0	−2.9	4.7	45.6
Retail grocery with and without meats	289.4	334.2	15.5	127.7	44.1
Hotels and other lodging places	76.2	77.9	2.2	31.8	41.7
Printing and publishing	37.3	46.0	23.3	14.8	39.7
Finance, insurance, and real estate	303.2	346.5	14.3	116.7	38.5
Retail meat and sea food	28.4	27.2	−4.2	10.7	37.7
Retail general merchandise	70.0	79.6	13.7	25.1	35.9
Motion pictures, service	11.7	13.6	16.2	4.2	35.9
Food and kindred product manufacturing	37.3	34.6	−7.2	11.6	31.1
Retail drugs	47.2	49.5	.7	7.9	16.7

Computed from, "Revised estimates of business population," Survey of Current Business June 1949.

Appendix B

Supplemental Data Reconstruction Finance Corporation

In addition to data presented elsewhere in these hearings, certain supplementary information was requested of the Reconstruction Finance Corporation in respect to its prewar lending operations. Selected portions of the information submitted by the Corporation in response to these several requests are given below:

"In the 22-month period from January 1, 1948, to November 1, 1949, the Corporation authorized 4,669 direct business loans; 519 of the borrowers involved had received loan authorizations prior to January 1, 1948; 64 had more than 1 loan authorization during the period and an additional loan authorization during a prior period; 156 received more than 1 loan authorization during the period and no authorizations during a prior period. In most cases the additional loan authorizations resulted from (*a*) cancellation of the previous authorization, (*b*) a direct loan made to a borrower in cases in which the Corporation had been requested by a bank (under a previous deferred participation contract) to purchase its share of the prior bank loan to the same borrower and refinancing of the loan appeared appropriate, or (*c*) additional requirements by the borrower to finance operations not contemplated at the time of the original authorization."

"As a general rule the conditions precedent to a loan and the terms of a loan are the same regardless of the type of industry or the size of the business enterprise to which the loan is made. The interest rate is the same and generally collateral requirements and repayment terms are the same, varying only on account of the specific needs of the borrower due to seasonal or other demands. Obviously each loan must be tailored to fit the applicant and in most cases special conditions are imposed which are deemed advisable for the protection of the Corporation.

"Since the inauguration of the business-loan program there have been no changes in the collateral requirements of the Corporation. There have been changes, however, in interest rates, maturities, and repayment terms. Originally, business loans carried a rate of 6 percent, which was the prevailing rate until May 15, 1935, when it was reduced to 5 percent. The present rate of 4 percent was established on April 1, 1939. At first our business loans generally were made for periods of 6 months and renewed from time to time. These maturities, however, were definite, with no assurance of extension or renewal, and did not provide the long-term needs of business. This practice was therefore discontinued and longer maturities were authorized, with repayments semiannually or quarterly. Except in unusual cases, repayment is now required in monthly installments."

"An analysis of loans exceeding $500,000 reveals that approximately 20 percent of such loans were made to borrowers which might be described as engaging in new enterprise; this category includes loans to borrowers established in a business who were extending their scope to new but usually related fields. Time has not permitted an analysis of the substantially greater volume of loans of less than $500,000, but it is apparent that the number of such loans that might be classified as "new venture" lans would be less than 20 percent of the total. Smaller concerns embarking upon new ventures usually have little, if any, experience or background in such ventures, and usually they are not able to acquire sufficient private capital to afford adequate assurance of repayment of a loan from the Corporation. This would not hold true, of course, in the case of loans made to veterans, who are able to obtain the guaranty of the Veterans' Administration under the terms of the Servicemen's Readjustment Act of 1944. The Corporation has made in excess of 2,000 such loans to veterans, most of which fall in the category of new enterprises.

"In answering the questions in your letter we have assumed that your inquiry was directed entirely to loans to business enterprises. The foregoing and the attached tabulation include business loans under (*a*) section 4 (a) (1) of the RFC Act, as amended, (except railroads), (*b*) section 102 of the Housing Act of 1948, and (*c*) the National Defense authority (sec. 5 (d) (2) of the RFC Act)."

Reconstruction Finance Corporation, 10 largest borrowers, as of Oct. 31, 1949

[Amounts shown are in thousands of dollars]

Name and address of borrower	Total	Direct loans		Participation loans	
		Undisbursed commitments	Disbursements (less repayments)	RFC share	Bank share
Kaiser Co., Inc., Oakland, Calif.	[1] 96, 123	240	95, 883		
Lustron Corp., Cicero, Ill.	[2] 37, 486		37, 486		
Kaiser-Frazer Corp., Willow Run, Mich.	[1] 44, 400	44, 400			
Lone Star Steel Co., Dallas, Tex.	34, 000	34, 000			
Reynolds Metals Co., Richmond, Va.	[3] 30, 700		30, 700		
Northwest Airlines, Minneapolis, Minn.	21, 000			12, 000	9, 000
Carthage Hydrocol, Inc., New York, N. Y. (plant, Brownsville, Tex)	18, 500	6, 750	11, 750		
Ketchikan Pulp & Paper, Ketchikan, Alaska	16, 000	16, 000			
Texas Petroleum Co., Dallas, Tex.	15, 100			10, 100	5, 000
McLouth Steel Corp., Detroit, Mich.	14, 500	1, 908	12, 592		
Total, 10 loans	327, 809	103, 298	188, 411	22, 100	14, 000
Total all loans	981, 345	266, 816	442, 604	172, 816	99, 109
Percent, 10 loans total	33. 4	38. 7	42. 6	12. 8	14. 1

[1] Includes $10,000,000 authorized to Kaiser-Frazer Sales Corp.

[2] Originally authorized, in accordance with the Veterans Emergency Housing Act, as a national defense loan under sec 5 (d) (2) of the RFC Act.

[3] Originally authorized as a National Defense Loan under sec. 5 (d) (2) of RFC Act.

Business loan authorizations, fiscal year ended June 30, 1949

BY TYPE OF INDUSTRY

	Number	Gross amount	RFC amount
Nonmanufacturing industries:			
Poultry farms, greenhouses, crop specialties, forestry, fisheries, etc.	77	$3, 152, 119	$2, 358, 429
Mining	61	5, 449, 514	4, 373, 127
Construction	264	13, 826, 191	11, 237, 909
Wholesale and retail trade	787	25, 762, 736	21, 461, 433
Finance, insurance, and real estate	62	39, 186, 862	34, 504, 494
Transportation, communication, and other public utilities	229	24, 754, 568	22, 619, 104
Services: personal, business, recreational, public, semipublic, professional, and other	540	14, 417, 996	12, 707, 934
Total	2, 020	126, 549, 986	109, 262, 430
Manufacturing industries:			
Food and kindred products	385	56, 281, 370	43, 075, 313
Textile mill products	50	12, 089, 250	11, 468, 700
Apparel and other products made from fabrics	27	1, 689, 267	1, 421, 486
Lumber and timber basic products	182	21, 377, 218	19, 840, 692
Furniture and finished lumber products	80	5, 190, 249	4, 612, 491
Paper and allied products	31	18, 902, 395	18, 721, 689
Printing, publishing, and allied industries	48	1, 966, 649	1, 798, 919
Chemical and allied products	68	11, 459, 402	10, 896, 502
Products of petroluem, coal, and natural gas	20	13, 297, 250	13, 214, 750
Rubber products	5	608, 000	608, 000
Leather and leather products	9	428, 000	276, 900
Stone, clay, and glass products	102	7, 513, 830	6, 829, 427
Iron and steel and their products	126	51, 517, 199	50, 462, 648
Transportation equipment (except automobiles)	24	13, 554, 517	12, 957, 117
Nonferrous metals and their products	34	11, 451, 457	11, 235, 991
Electrical machinery	50	6, 837, 332	6, 349, 116
Machinery (except electrical)	164	11, 668, 588	10, 416, 682
Automobiles and automobile equipment	20	11, 531, 067	11, 222, 276
Miscellaneous manufacturing industries	64	4, 630, 149	4, 254, 559
Total	1, 489	261, 993, 189	239, 663, 258
Grand total	3, 509	388, 543, 175	348, 925, 688

Business loan authorizations, fiscal year ended June 30, 1949—Continued

BY SIZE

	Number	Gross amount	RFC amount
$5,000 and under	592	$1, 745, 946	$1, 690, 336
$5,001 to $10,000	442	3, 443, 416	3, 082, 641
$10,001 to $25,000	789	14, 130, 746	12, 181, 476
Total $25,000 and under	1, 823	19, 320, 108	16, 954, 453
$25,001 to $50,000	685	26, 795, 063	22, 676, 821
$50,001 to $100,000	565	44, 132, 234	37, 820, 765
Total, $25,001 to $100,000	1, 250	70, 927, 297	60, 497, 586
$100,001 to $200,000	176	26, 538, 196	23, 036, 376
$200,001 to $500,000	167	54, 301, 535	48, 023, 451
Total, $100,001 to $500,000	343	80, 839, 731	71, 059. 827
$500,001 to $1,000,000	44	31, 238, 637	28, 105, 603
Over $1,000,000	49	186, 217, 402	172, 308, 219
Total $500,001 or more	93	217, 456, 039	200, 413, 822
Grand total	3, 509	388, 543. 175	348, 925, 688

BY USE OF PROCEEDS

	Percent	RFC amount
Working capital	45. 5	$158, 756, 073
Construction	20. 2	70, 663, 340
Debt payment	19. 3	67, 320, 176
Machinery and equipment	13. 9	48, 548, 639
Purchase of real estate or business	1. 0	3, 353, 986
Other	. 1	283, 474
Total	100. 0	348, 925, 688

Appendix C

Item 1

TOPICS AND QUESTIONS WHICH WITNESSES WERE ASKED TO CONSIDER

A. Businessmen and business executives

I. What kind of pay-off periods do you require on new equipment investment?

(*a*) Do the rates of depreciation, which you and your accountants feel proper, differ from those allowed for tax purposes?

(*b*) In other words, do you take the same rates of depreciation for book and for income tax purposes?

(*c*) Do you make it a practice to review and revise depreciation rates during life of the equipment to give recognition to altered market or replacement conditions?

II. How are replacement expenditures planned?

(*a*) Who initiates the plans and upon what facts or forecast?

(*b*) How far in advance are replacement plans initiated?

(*c*) What data on repairs, lost time, etc., of the old machine and what knowledge of the efficiency of the replacement model are available?

(*d*) What accounting distribution is made of any remaining book value of the existing equipment?

(*e*) Has the Bureau of Internal Revenue ever taken exceptions to the deductibility of remaining book value?

(*f*) What factors affect the timing of decisions to replace, for example, age of the old machine, labor-saving, or efficiency aspects of new machines?

III. How are new opportunities for profitable investment discovered and ripened into investment commitments?

(*a*) Do you have a research and development division? Are they responsible for thinking up new ideas for profitable investment? Do they screen them? All of them?

(*b*) Do you rely on market studies for knowledge of consumers' demand and changes in it?

(*c*) To what extent is reliance placed on professional outside analysts, sampling studies?

(*d*) What are the respective roles of the sales department, the cost-accounting department, in the conferences where expansion programs are considered?

(*e*) Who ultimately makes the decision to invest? Do you ever expand plant capacity at times when existing capacity is less than fully utilized?

IV. To what extent must the possibility that others are simultaneously contemplating investment be considered in arriving at your decisions?

(*a*) Does your firm find it necessary to keep ahead of the investment plans of others?

(*b*) If you are sure that competitors are expanding plant capacity, do you in order to hold your market try to reach the market with the output of expanded facilities at substantially the same time or earlier if possible?

(*c*) Are investment opportunities, once recognized, ever passed over? Why?

V. How long a time elapses between the time a decision to invest is made and the time when products from the facilities are available for meeting market demands?

(*a*) How much time is used up between the date the decision to invest is made and the date the commitment is made or contracts signed?

(*b*) How serious are possibilities of change in demand during the period while the facilities are being brought into production?

(*c*) Do you require firm contracts for the output of facilities before undertaking their construction?

VI. In what way does the availability or unavailability of funds enter into programing once an investment opportunity has been recognized?

(*a*) In how many years do you figure you ought to get your money back before you put up new plant or equipment? Is that number the same at all times?

(*b*) If you have a profitable opportunity to invest, how important is the interest rate? The length of time for which you can get the money?

(*c*) How does the rate of return being made on existing investments affect the required return on new investment?

(*d*) Are contracts for new plant equipment ever let before funds are available or underwritten?

VII. When are decisions made and investment plans undertaken in relation to the peaks of production demand?

(*a*) In the past have you ever made investment and expansion plans and expenditures at the top of a boom?

(*b*) Are there any automatic checks upon business judgment which will deter expansion in the face of currently peak sales and profits?

VIII. What is the minimum investment required to start a new enterprise in your industry?

(*a*) In your opinion, what would be the principal obstacles such an enterprise would have to face?

(*b*) Do you ever help finance the purchase of your product or your raw materials? In your industry is there any significant amount of either upstream or downstream financing of nonaffiliated companies?

(*c*) Have terms or requirements of commercial credit changed significantly since, say, the 1920's? Are they varied from time to time depending upon volume of orders on hand?

IX. Does your company have any plans in respect to either foreign sales or foreign investment?

(*a*) Do you know or believe there are opportunities for profitable investment in your industry in foreign countries? If not, why not?

(*b*) Do you know or believe that there are attractive foreign markets for American products of your industry? If not, why not?

X. What can be done by organized efforts of business or by Government to minimize the variability of gross investment expenditures?

(*a*) Having in mind for the moment the problem of variability rather than the amount of investment, are there any governmental programs which you feel contribute specifically to such variability? Are there any programs which might be adopted to minimize the instability of private investment?

(b) Do you feel that it is necessary and proper that Government expenditures be employed to complement business investment expenditures when the latter show declines?

(c) At what point in the planning of investment expenditures does the question of relative return after taxes enter the discussion?

(d) Are there governmental policies which deter you from making much larger investments than you do now? What are they? If removed concretely what kind of new plant and how much would you then build?

B. Executives and representatives of insurance companies

I. Portfolio management in general—

(a) If existing restriction on qualified investments were eliminated entirely, how would you alter the proportions or holdings of your present portfolio?

(b) In appraising the possibilities of a new investment item, do you have a minimum amount below which you feel it is impractical or too costly to go? How was this amount arrived at, that is, what considerations determine the figure?

(c) In appraising the possibilities of a new investment item, do you have a maximum above which you feel it is inexpedient or too lacking in diversification for acquisition? How was this amount arrived at, that is, what considerations determine the figure?

II. Fixed interest debt obligations are a traditional media for insurance-company investment—

(a) As a regular investor in evidences of debt, what evidences do you see suggesting a shortage of equity capital?

(b) For various types of debt securities what ratio of underlying equity do you feel is necessary?

(c) Has there been any change in recent years in the attitude of either business or financial institutions in an acceptable debt/equity ratio?

(d) It is sometimes said that there has been a relative scarcity of corporate bond issues in recent years. (1) Would you agree? (2) How does this fit in with an asserted shortage of equity capital? (3) Is the scarcity the result of a shift in the situation of corporate borrowers and hence in the absolute amounts available or is it the result of larger funds seeking this type of fixed investments?

III. Private placements—

(a) Are so-called private placements initiated typically by (1) the borrower, (2) an intermediary, (3) the prospective creditor? What provisions are made for watching, supervising, or controlling the debtor's use of funds and the subsequent management of the business in the interest of debt service and ultimate repayment?

(b) Are bonds acquired through direct placement subject to different valuation procedures than those acquired in the market?

IV. Investment in common stocks:

(a) Does your company now hold the maximum amount of common stock permitted under statutory limitations? If not, why not?

(b) How are common stock holdings valued in making up the balance sheet and computing reserve?

(c) Was the decision to enter the common stock field dictated primarily by: (1) A search for suitable use of funds? (2) Their relative attractiveness on an earning basis? (3) The desire or need for diversification?

(d) What is the company's policy in respect to the voting of common stock held for investment purposes? How are such investments otherwise supervised?

V. Direct investments—particularly in residential or commercial real estate:

(a) Does your company now hold the maximum amount of direct real-estate investment permitted under statutory limitations?

(b) How are direct investments in real estate valued in making up the balance sheet and computing reserve?

(c) Was the decision to enter the direct-investment field dictated by (1) a search for suitable use of funds; (2) relative attractiveness on an earning basis; (3) desire or need for diversification?

VI. Sale and lease-back investment:

(a) Why was this relatively new form of investment developed?

(*b*) Describe the form of lease employed, especially in respect to default provisions.

(*c*) How do these differ in degree or effect from default provisions such as are ordinarily inserted in debenture agreements?

(*d*) Do you regard these sale and lease-back investments as business equities or debt?

VII. Governmental policies:

(*a*) What can be done by organized efforts of business, financial institutions, or Government to obtain the optimum rate of investment and to minimize the variability of gross private investment expenditures?

(*b*) Does your company have any program for timing direct investments or the purchase of other securities, or is the time controlled solely by the flow of funds?

(*c*) Having in mind for the moment the problem of variability rather than the amount of investment, are there any Government programs which you feel contribute specifically to such variability? Are there any programs which might be adopted to minimize the instability of private investment?

(*d*) Do you feel that it is necessary and proper that Government expenditures be employed to complement business investment expenditures in order to maintain an optimum rate of investment when business investment shows a tendency to decline?

C. Investment bankers

I. Traditionally the functions performed by investment bankers included (1) "origination," (2) underwriting, (3) distribution of securities, (4) continuing financial counsel to capital users:

(*a*) What, if any, changes have there been in the past decade in the nature or emphasis given to each class of such services?

(*b*) Has the growth of institutional investors employing technique of private placement, sale and lease-back, etc., altered the role of investment bankers?

II. In connection with "origination" or the buying of securities—

(*a*) What do you consider to be a minimum issue for public distribution? For private distribution?

(*b*) What implication does this have for the financing of small business?

(*c*) How does the need or opportunity for a financial transaction or security flotation come to your attention?

(*d*) What procedures or programs are there for discovering new business in the sense of locating and promoting the issuance and sale of permanent securities?

III. In connection with underwriting—

(*a*) Does the procedure of private placement eliminate all necessity for underwriting in the accepted sense of the word?

(*b*) Why has not the relative stability which has characterized security markets in recent years been ideal in eliminating many of the risks of underwriting?

IV. In respect to distribution of securities—

(*a*) Would the market for common stocks be aided, in your opinion, by the distribution in dividends of a larger proportion of corporate earnings?

(*b*) To what extent does the availability and marketing of tax-free State, municipal, or guaranteed issues affect the marketing of corporate securities?

V. In respect to continuing financial counsel—

(*a*) What considerations determine the minimum price at which common stock will be offered?

(*b*) Is it to your knowledge customary in private placement for the purchaser to require representation on the board of directors of the borrowing or capital using corporation?

(*c*) In the absence of such representation, what methods for supervision are employed, or must the financing be denied completely?

VI. In respect to foreign trade—

(*a*) Do you know or believe there are opportunities for profitable investment in foreign countries? If not, why not?

(*b*) Do you know or believe that there are attractive untapped foreign markets for American products? If not, why not?

(*c*) What suggestions do you have to stimulate the imports essential and incident to the maintenance of the United States' role as a creditor nation?

VII. What can be done by organized efforts of business, financial institutions, or Government to obtain the optimum rate of investment expenditures?

(*a*) Accepting for purposes of discussion the position that Government must continue to raise substantially the present amount in the form of taxes, what form of taxes do you regard as least disturbing to incentives and stability?

(*b*) Are there any Government programs which you feel contribute to variability of private investment?

(*c*) Do you feel that it is necessary and proper that Government expenditures be employed to complement business investment expenditures in order to maintain an optimum rate of investment when business investment shows a tendency to decline?

(*d*) Suppose all deterrents to investment, for which you regard governmental policy responsible, were removed would your company change its investment program radically? If so, how? Do you know of other investment programs that would be altered or encouraged thereby? If so, what?